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IN THE

Supreme Court of the United States

OCTOBER TERM, 1969

Nos. 920 and 921

THE CHASE MANHATTAN BANK, N.A., as Trustee under the General Income Mortgage of The New York, New Haven and Hartford Railroad Company,

Appellant-Petitioner-Respondent,

v.

PENN CENTRAL COMPANY, UNITED STATES OF AMERICA, and INTERSTATE COMMERCE COMMISSION, *et al.*,

Appellees-Respondents-Petitioners.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK AND ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT BEFORE JUDGMENT

BRIEF FOR THE CHASE MANHATTAN BANK, N.A., AS TRUSTEE, APPELLANT-PETITIONER-RESPONDENT

Introduction

These two appeals in this Court, No. 920 (on certiorari) and No. 921 (on appeal), are among a number of cases in this Court which have been termed by government counsel "The New Haven Inclusion Cases". The other such cases are Nos. 914, 915, 916, 917, 1038 and 1057. All such cases have been consolidated by this Court's Order dated February 2, 1970.

The New Haven Inclusion Cases all relate to the amount of the consideration which should be paid by Penn Central Company (Penn Central) to the estate of The New York, New Haven and Hartford Railroad Company (the New Haven) in connection with the inclusion of the New Haven in Penn Central.

These two appeals of The Chase Manhattan Bank, N.A., as Indenture Trustee (Chase) under the General Income Mortgage of the New Haven, are the outgrowth of extended proceedings before the Interstate Commerce Commission (the Commission) and before two Courts (the District of Connecticut Reorganization Court acting under Section 77 of the Bankruptcy Act and a three-Judge Court in the Southern District of New York acting to review Commission action taken under the Interstate Commerce Act). These two Courts having jurisdiction under different statutes to review the terms of the New Haven inclusion which were approved by the Commission, the exercise of such jurisdiction has resulted in conflicting decisions of the two Courts.* These Chase appeals also bring before this Court some issues on which the two Courts below agreed.

Because the statutory methods of review of the decisions of the two Courts were different, it was necessary, in order to bring the decisions of both Courts to this Court for review, for Chase not only to appeal to this Court from the three-Judge Court decision but also to petition this Court for a writ of certiorari to the United States Court of Appeals for the Second Circuit before judgment in order to review the Reorganization Court judgment in respect of the same appeal issues.

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* To the extent that the decision of the three-Judge Court was in conflict with the decision of the Reorganization Court, one of the three Judges dissented and took no part in the rendition of its final decree.

The Commission, the Department of Justice and Penn Central have not appealed from the decision of the two-Judge majority but they did file certiorari petitions (Nos. 1038 and 1057) asking this Court to review the Reorganization Court decision on those issues on which the Reorganization Court disagreed with the two-Judge majority. Accordingly, Chase, in addition to being an appellant and a petitioner, is also a respondent in respect of such two certiorari petitions.

Opinions Below

The decisions below are printed in a common Appendix of Decisions and Constitutional and Statutory Provisions (the pages of such common Appendix being hereinafter referred to as "App.").

The majority and minority opinions of the three-Judge Court filed June 18, 1969 and the memorandum and decree of the majority filed September 11, 1969 (which relate to the Commission's Fourth Supplemental Report) have not yet been reported but appear at App. 400a, 431a, 444a and 446a. The Commission's Fourth Supplemental Report and Order dated November 25, 1968 are reported at 334 I.C.C. 25 (App. 112a).

The earlier majority and minority opinions of the three-Judge Court dated July 10, 1968 on the same subject-matter but directed to the Commission's Second Supplemental Report are reported at 289 F. Supp. 418 (App. 323a, 376a and 379a).

The Second Supplemental Report of the Commission dated November 16, 1967 is reported at 331 I.C.C. 643 (App. 1a).

The opinion of the Reorganization Court filed May 28, 1969 and directed to the Fourth Supplemental Report is reported at 304 F. Supp. 793 (App. 277a). The July 28, 1969 Memorandum of Decision of the Reorganization Court relating in part to the price issue is reported at 304 F. Supp. 1121 (App. 312a) and its July 28, 1969 Order as to price is reported at 304 F.Supp. 1136 (App. 316a).

The earlier opinion in this litigation of the Reorganization Court directed to the Second Supplemental Report is dated August 10, 1968 and is reported at 289 F. Supp. 451 (App. 237a).

The Commission's Fifth Supplemental Report as modified August 26, 1969 was issued without notice to any party or any hearing and *after* both Courts had rendered their opinions and is reported at 334 I.C.C. 528 (App. 222a).

Only the three Reports of the Commission listed above relate to the consideration to be paid for the New Haven assets. Its first and third supplemental reports do not relate to that issue.

Jurisdiction

Suit was brought by Chase in the three-Judge Court to annul, set aside and enjoin the enforcement of, the Commission's Fourth Supplemental Report and Order (App. 112a) made under Section 5(2) of the Interstate Commerce Act and prescribing the consideration payable by Penn Central to the New Haven for its assets. The decree of the three-Judge Court sought to be reviewed by this Court on appeal (App. 446a) is dated September 11, 1969 and was entered on that date. The Chase Notice of Appeal was filed on October 9, 1969 in the United States District Court for the Southern District of New York. The Chase Jurisdictional Statement was filed in this Court on December 5, 1969 and the Court noted probable jurisdiction on Febru-

ary 2, 1970. The jurisdiction of this Court over the appeal from the decree of the three-Judge Court is invoked pursuant to 28 U.S.C. §1253.

The judgment sought to be reviewed on certiorari is the final order (304 F.Supp. 1136, App. 316a) concerning price issues made by the Reorganization Court under Section 77 of the Bankruptcy Act. Said Order was dated July 28, 1969 and was entered on the same date. Chase appealed to the Court of Appeals for the Second Circuit from said Order's determination of price issues by filing on August 26, 1969 a Notice of Appeal of the same date in the Reorganization Court. The petition for certiorari filed in this Court to review the case in said Court of Appeals before rendition of judgment was filed on December 5, 1969 and was granted on February 2, 1970. The jurisdiction of this Court by means of the writ of certiorari rests on 28 U.S.C. §1254(1).

Provisions of Constitution and Statutes Involved

The following constitutional and statutory provisions are involved and are printed in the Appendix of Decisions and Constitutional and Statutory Provisions:

The Fifth Amendment to the Constitution of the United States (App. 453a).

Section 5(2) of the Interstate Commerce Act, 24 Stat. 379 (1887), 49 U.S.C. §5(2) (1964) (App. 453a).

Sections 1(18) and 1(20) of the Interstate Commerce Act, 24 Stat. 379 (1887), 49 U.S.C. §§1(18) and 1(20) (1964) (App. 457a).

Provisions of Section 77(b), (d) and (e) of the Bankruptcy Act, 47 Stat. 1474 (1933), 11 U.S.C. §205(b), (d) and (e) (1964) (App. 458a, 461a and 463a).

Statement of the Case

This brief is submitted on behalf of The Chase Manhattan Bank, N.A., as Indenture Trustee under the General Income Mortgage of the New Haven, which mortgage secures $52,755,500 principal amount of Bonds, on which $7,121,994 of pre-bankruptcy interest is accrued and unpaid.*

The proceeding for reorganization of the New Haven under Section 77 of the Bankruptcy Act commenced on July 7, 1961 in the District Court for the District of Connecticut presided over by Judge Anderson, Chief Judge of the District Court. He continued to preside over the Reorganization Court when he became a Circuit Judge, thereafter sitting by designation.

In 1962, Penn and Central instituted a proceeding before the Commission under Section 5(2) of the Interstate Commerce Act (App. 453a) for authority to merge. The New Haven Section 77 Trustees intervened in that proceeding asking that, as a condition of the merger, Penn and Central be required to give the New Haven the option of being included.

In its Report and Order dated April 6, 1966, the Commission authorized the merger of Penn and Central subject to the following first paragraph of Condition 8 relating to the inclusion of the New Haven (327 I.C.C. at p. 553):

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* These Bonds were issued in the 1947 reorganization of the New Haven under Section 77 of the Bankruptcy Act to holders of various defaulted debt securities of the New Haven system. The Bonds were secured by a system mortgage running to an Indenture Trustee, The Chase National Bank of the City of New York, which in 1955 became The Chase Manhattan Bank, N.A. The Bonds are junior to, and therefore have a position different from, the system First and Refunding Mortgage Bonds. Accordingly, it has seemed inappropriate as well as impracticable for Chase, as Trustee under the General Income Mortgage, to join in a brief on this appeal with representatives of the First and Refunding Mortgage interests.

"8. The Pennsylvania New York Central Transportation Company shall be required to include in the transaction all the New York, New Haven and Hartford Railroad Company—the inclusion of passenger operations being subject to the findings and determinations of the Commission as set forth in Finance Docket No. 23831 issued simultaneously with this report—upon such fair and equitable terms as the parties may agree subject to the approval of the Bankruptcy Court and the Commission. Within 6 months after the date this report is served, the parties shall file with the Commission for its approval, a plan for such inclusion. In the event the parties are unable to reach an agreement (and subject to approval by the Bankruptcy Court) such inclusion shall be upon such fair and equitable terms and conditions as the Commission may impose."

Thus, the Reorganization Court was made the coequal arbiter along with the Commission as to the price or consideration, as well as having to pass judgment on the price as part of the reorganization of the New Haven under Section 77 of the Bankruptcy Act. Condition 8 (third paragraph) further provided (327 I.C.C. at p. 553) that consummation of the merger by Penn and Central shall indicate their full and complete assent to the requirements of Condition 8. This Court has ruled that Penn Central "will perforce accept" such conditions "by its act of merger" (*Penn-Central Merger Cases*, 389 U.S. at p. 510).

In October 1966, the New Haven's Trustees filed with the Reorganization Court and with the Commission "Step I" of a plan of reorganization proposing terms and conditions upon which assets of the New Haven would be acquired by Penn and Central in connection with their merger. Penn and Central joined in asking the Commission

and the Court for approval of such terms and conditions. This incomplete plan of reorganization has been termed Step I in these proceedings since it envisaged that, after the sale of the New Haven to Penn Central and the determination of the consideration to be paid to the New Haven, the remainder of the plan of reorganization, namely, provisions concerning the capitalization of the reorganized New Haven and the allocation of its securities among its creditors, would be proposed as "Step II". (Step II has since been proposed, but Step II issues were not before the three-Judge Court and are not being presented to this Court in the present review proceedings.)

Penn and Central, after secret negotiations with the Section 77 Trustees of the New Haven who refused to inform the New Haven security holders of how they were proceeding, had entered into a tentative agreement in April 1966 with such Trustees for the purchase of the New Haven assets, which agreement was expressly subject to the approval of the Commission and the Reorganization Court and was further subject to effectuation of the Penn Central merger. The approval of the Reorganization Court was never obtained by the New Haven Trustees, nor was it requested until they made their application for approval of Step I which included such purchase agreement.

Following hearings before the Commission commencing in January, 1967, it rendered its Second Supplemental Report and Order dated November 16, 1967 (App. 1a, 466a), approving the consideration to be paid by Penn Central to the New Haven's Trustees substantially as provided in the above-mentioned agreement which has never been authorized by the Reorganization Court. The Commission found the liquidation value of the New Haven assets to be sold to Penn Central to be $128,900,000 on December 31, 1966 (which it rounded off to $125,000,000) and the value

of the proposed consideration to be $123,600,000 (which it again rounded off to $125,000,000) (App. 330a). Such consideration consisted principally of 950,000 shares of Penn Central stock (taken at $87.50 per share), $23,000,000 of Penn Central 5% Bonds and $8,000,000 of cash (App. 350a).

Believing that such liquidation value finding was far too low and that the proposed consideration was grossly inadequate, representatives of the New Haven's bondholders commenced proceedings in the three-Judge Court to review the Commission's Second Supplemental Report and Order. The Report and Order had also been certified to the Reorganization Court as part of a plan of reorganization under Section 77 of the Bankruptcy Act and were similarly opposed in that Court. The two Courts recognized that they each had separate jurisdiction to review the Step I issues. The three-Judge Court had jurisdiction to review the Commission's decision on such issues because the decision was made under Section 5(2) of the Interstate Commerce Act, while the Reorganization Court had jurisdiction under Section 77 of the Bankruptcy Act over all parts of a plan of reorganization as well as jurisdiction under the Commission's Condition 8 over the terms and conditions of the inclusion of the New Haven in Penn Central.

That there would be review both by the Reorganization Court and a statutory District Court was indicated by this Court's opinion in *Penn-Central Merger Cases*, 389 U. S. 486 (Jan. 15, 1968) at pp. 507-511. There this Court (at p. 507 *et seq.*) briefly describes some of the history of the New Haven proceeding and at p. 509 notes that the inclusion terms in the Commission's Second Supplemental Report had "not been reviewed by the bankruptcy court or by a statutory district court under the applicable statute." This Court ruled (p. 511) that such review could

take place after consummation of the Penn Central merger. The Penn Central merger was effected February 1, 1968. The New Haven was included eleven months later, December 31, 1968.

Both Courts below held in their initial decisions that the proposed Step I price approved in the Commission's Second Supplemental Report was inadequate by many millions of dollars ($45,000,000 to $50,000,000, 289 F. Supp. at p. 440, as decided by the three-Judge Court in July 1968 (App. 358a); and $33,000,000 to $55,000,000, 289 F. Supp. at p. 465, as decided by the Reorganization Court in August 1968 (App. 256a)). Therefore, both Courts remanded the proceedings to the Commission.

The Commission ordered accelerated hearings and an accelerated briefing schedule and thereafter issued its Fourth Supplemental Report and Order dated November 25, 1968 (334 I.C.C. 25, App. 112a *et seq.*), increasing the price payable by Penn Central by some $15,000,000* which was far less than had been indicated in the remand decisions of the two Courts. What the Commission did was to increase its $125,000,000 liquidation value finding to $162,700,000 and then to deduct $22,000,000 from such value for alleged reasons hereinafter to be discussed (and refuted).

In such Fourth Supplemental Report and Order, the Commission, subject to the approval of the Reorganization Court, directed Penn Central to take over the New Haven at the end of 1968 upon payment of the consideration which had been approved by the Commission (although not by the Reorganization Court), without prejudice to further litigation as to the price and terms of the inclusion (App. 219a, 163a). The Reorganization Court approved the take-

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* Exclusive of $5,000,000 to be paid for only a portion of the losses from the date of the Penn Central merger to the date of the inclusion of the New Haven assets.

The increase is only $11,100,000 over the $128,900,000 original liquidation value finding before that finding was "rounded off" by the Commission.

over by an order dated December 24, 1968 (App. 269a), also without prejudice as to contesting the consideration (App. 275a).

Thereafter, the Reorganization Court, the coequal arbiter under Condition 8, disapproved as too low by at least $28,000,000 and possibly $98,000,000, the revised consideration fixed by the Commission, while the three-Judge Court, one Judge dissenting, approved such consideration, in substance.

Accordingly, two Judges, Friendly, Circuit Judge, and Levet, District Judge, have approved such consideration, and two Judges, Anderson, Circuit Judge (sitting by designation in the Reorganization Court), and Weinfeld, District Judge, have disapproved such consideration as far too low.

The majority of the three-Judge Court and the Reorganization Court thereupon entered conflicting orders to carry out their respective decisions. The result is a stalemate, with the purchaser, Penn Central, and the seller, the New Haven, being subject to conflicting decrees regarding the consideration to be paid by Penn Central for the New Haven assets.

In addition, as will hereinafter appear, both Courts agreed, erroneously we submit, in rejecting bondholders' contentions on some issues (the Reorganization Court doing so *dubitante* on the important issue relating to the valuation of the New Haven's partnership interest in the Grand Central properties*).

* The Reorganization Court supported its conclusion that appeals to this Court were inevitable by referring, among other things, to non-payment by Penn Central under the decisions below for a major portion of such partnership interest, stating that, if such New Haven interest were to be recognized, "the evidence presently in the record would show a potential worth of approximately $70 million" (304 F. Supp. at p. 1124, App. 314a-315a).

As already mentioned, neither the governmental parties nor Penn Central appealed from the decision of the majority of the three-Judge Court but they both filed petitions for certiorari in respect of the Reorganization Court decision to the extent that it disagreed with that of the two-Judge majority.

As indicated above, the Chase appeals bring before this Court not only the issues as to which the two Courts below were in disagreement but also some important issues as to which both Courts decided against the bondholder interests. The appeal issues will be set forth hereinafter in the "Questions Presented" and will be discussed in the argument which follows.

The bondholder interests found it unnecessary to seek early review of the interlocutory three-Judge Court decision dated July 10, 1968 because, under the holding in *United States* v. *U. S. Smelting Co.*, 339 U.S. 186, 198-9 (1950), their right of review of the interlocutory decision under the Interstate Commerce Act was preserved for hearing with their appeals from the final judgment. A similar holding was not found in respect of review of the August 10, 1968 interlocutory decision of the Reorganization Court under the Bankruptcy Act. Therefore, the bondholder interests did appeal from the unfavorable portions of the latter decision to the Court of Appeals for the Second Circuit; and such appeals have been consolidated with the later bondholders' appeals, all of which are now before this Court.

The Government petition for certiorari (p. 9) has sought to divert attention from the issues of law involved in the consolidated appeals by referring to them as merely a difference of opinion between the Judges below as to the amount of proper deference to the Commission's finding of liquidation value. In their January 1970 Memorandum

heretofore filed in this Court, the Government attorneys likewise state (p. 17) that there is a single underlying issue to be decided by this Court "as to the relative roles of the Commission and the courts in matters of this nature."

We submit that the issue here is not as to the relative roles of the Commission and the Courts on matters of valuation; the legal principles concerning such relative roles are well-settled. What is not settled and is to be decided in the present case is (a) whether the Commission may be allowed to negate the fundamental constitutional right of bondholders to obtain liquidation or salvage value of the railroad's properties when there is no longer any hope of its profitable operation, (b) whether the bondholders' security may be confiscated without just compensation on the basis of a finding that there is a public need for the continued operation of the unprofitable railroad and (c) whether in fixing the price to be paid for the bondholders' security the Commission may proceed arbitrarily and capriciously without following any legal valuation standard and without substantial support in the record.

Questions Presented

1. Whether, after the Commission, pursuant to Section 5(2) of the Interstate Commerce Act, had approved the application of Penn and Central to merge on condition that the merged company acquire the railroad operations and assets of the New Haven on fair and equitable terms as determined by the Commission and the Reorganization Court, the New Haven was entitled to receive as compensation from Penn Central at least the liquidation value of the New Haven assets required to be transferred to Penn Central, which the New Haven could have realized on such assets if they had been condemned or if the New Haven had been liquidated? (Discussed in I below)

2. Whether, in the case of a deficit railroad such as the New Haven, the Commission could legally reject net liquidation value as the valuation standard for such New Haven assets and arbitrarily announce as fair and equitable a value and price for such assets which it arrived at without having followed any legal standard of valuation? (Discussed in I below)

3. Whether, after the New Haven had been operated for over seven years in proceedings under Section 77 of the Bankruptcy Act with large and increasing operating losses and without any prospect of decreasing such losses or operating as a profitable railroad, the New Haven and its creditors would have the right to discontinue the losing railroad operations and realize the liquidation value of the remaining New Haven assets pursuant to the Fifth Amendment of the Constitution of the United States prohibiting the taking of private property for public use without just compensation and prohibiting deprivation of property without due process of law? (Discussed in I below)

4. Whether the unanimous conclusion of the three-Judge Court in its July 1968 decision, concurred in by the Reorganization Court in its August 1968 decision, (a) that the price payable by Penn Central could not be less than liquidation value and (b) that §1(18) of the Interstate Commerce Act calling for the Commission's consent to an abandonment could not stand in the way of a liquidation valuation as of December 31, 1966 because of the New Haven's constitutional right on the facts shown by the record to cease its railroad operations, was the law of the case which should not have been departed from in the Commission's Fourth Supplemental Report or in the opinion of the majority of the three-Judge Court filed June 18, 1969? (Discussed in I below)

5. Whether Penn Central's present inability to realize by sale the net liquidation value of the New Haven assets sold to it because Penn Central was required in the public interest to continue the deficit New Haven operations, which Penn Central had agreed to do as a condition of being permitted to effect the merger of Penn and Central, was a legal basis for the Commission's prescribing a price payable by Penn Central to the New Haven substantially below the net liquidation value which the New Haven could have realized for such assets in liquidation? (Discussed in I below)

6. Whether, after the three-Judge Court and the Reorganization Court in the summer of 1968 determined (a) that the Commission's finding that about $125,000,000 of net proceeds would be realized in a liquidation by the New Haven of the assets here involved over a six-year liquidation period was erroneous because it was far below net liquidation value and (b) that net liquidation value was the minimum to which the New Haven was entitled, and after the two Courts had therefore remanded the proceedings to the Commission for a substantial increase of its rejected finding of liquidation value, the Commission acted arbitrarily, capriciously and without substantial support in the record by increasing its net liquidation value finding only to $162,700,000 and by then reducing that revised liquidation value finding by the device of injecting (i) an additional year's delay of the six-year liquidation period which would allegedly reduce the revised finding of net liquidation value by $15,386,000 and (ii) a new so-called bulk sale discount of $6,695,000 which would further reduce such net liquidation value? (Discussed in II, III, V and VI below)

7. Whether, after the three-Judge Court in its July 1968 decision determined that the Commission's $125,000,000

finding of the liquidation value of the New Haven assets, based on a six-year liquidation period, might well be inadequate in the range of $45,000,000 to $50,000,000 (the Reorganization Court in its August 1968 decision finding the range of deficiency to be between $33,000,000 and $55,000,000) and after both Courts remanded the respective proceedings to the Commission for further action in accordance with the opinions of the two Courts, which opinions in no way questioned the six-year liquidation period, the Commission lacked power largely to increase its finding of liquidation expenses by stretching out the liquidation period by an additional year and by adding a large new item of expense for the purpose of decreasing its revised net liquidation value finding of $162,700,000 by $22,000,000? (Discussed in II(a) and (b) below)

8. Whether the price of approximately $141,600,000 payable by Penn Central for the New Haven assets prescribed by the Commission in its Fourth Supplemental Report as modified and approved by the majority of the three-Judge Court, which price was far less than the net liquidation value of such assets, was without substantial support in the record and was arbitrary and capricious? (Discussed in II, III, V and VI below)

9. Whether, after concluding that the New Haven had a 50% interest in those net earnings of the Grand Central Terminal hotels and office buildings which were in excess of the amount thereof used to defray Terminal expenses, the Commission acted arbitrarily and capriciously and without substantial support in the record in ruling that the New Haven's interest (about $5,600,000 annually) in those hotel and office building net earnings which had been used to defray the Terminal expenses payable by reason of the New Haven's railroad operations was to be transferred by the New Haven to Penn Central free and clear of any re-

striction without the New Haven's receiving any compensation therefor, although potentially worth some $70,000,000? (Discussed in III below)

10. Whether the Commission erred in arbitrarily limiting to $5,000,000 the amount which Penn Central should bear of the more than $10,000,000 of losses of the New Haven incurred by reason of the deferment for Penn Central's convenience and benefit of New Haven's inclusion in Penn Central from February 1, 1968 (when Penn and Central were merged) until December 31, 1968? (Discussed in IV below)

11. Whether the Commission erred in arbitrarily excluding certain items of loss from the formula determining the amount which Penn Central should bear of the New Haven losses for the eleven-month period commencing February 1, 1968? (Discussed in IV below)

12. Whether the Commission was arbitrary and capricious and without substantial support in the record in accepting as the value of the New Haven's Harlem River and Oak Point Yards the $18,100,000 appraisal thereof which assumed cessation of railroad service to such Yards upon the New Haven's liquidation instead of the adjusted $22,540,000 appraisal thereof by the same appraiser which assumed that railroad service to those Yards would be continued? (Discussed in V below)

13. Whether the Commission's failure to reduce by at least $2,415,000 the $17,563,000 discount to present worth which the Commission deducted in its valuation of the New Haven assets being sold to Penn Central was arbitrary and capricious and without substantial support in the record? (Discussed in VI below)

14. Whether the formula devised by the Reorganization Court and adopted in substance by the majority of the three-Judge Court and the Commission to guarantee the value per share assigned (or to be assigned) to the shares of Penn Central stock received by the New Haven should be revised and, as so revised, should be approved? (Discussed in VII below)

Summary of Argument

The Judges below have unanimously ruled that, in view of the deficit operations of the New Haven for over seven years and the utter futility of expecting any positive earnings in the future from its operation as an independent railroad, the New Haven would be entitled, under the decisions of this Court, to discontinue railroad operations and to proceed to realize liquidation or salvage value for its assets.

However, because of the Commission's emphatic finding that continuance of the New Haven's operations was essential in the public interest notwithstanding that such operations could be continued only at large losses, the New Haven has not been allowed to discontinue operations but its assets have been acquired by Penn Central which has agreed to continue the deficit New Haven operations as a condition of being allowed to effect the Penn Central merger.

In these circumstances, a fair and equitable price to be paid by Penn Central to the New Haven for its assets is the liquidation or salvage value which the New Haven would have realized if its properties had been liquidated or condemned; and the New Haven and its bondholders are constitutionally entitled to be paid such price by Penn Central.

Such price may not be reduced to reflect future operating losses of the New Haven line which are to be borne by Penn Central since that would in effect deprive the New Haven and its bondholders of their constitutional right to discontinue railroad operations because of the operating losses and thereupon to obtain liquidation value of the New Haven's assets (with the operating losses ceasing upon the commencement of the New Haven's liquidation).

The Commission has sought to reduce the price payable by Penn Central to an amount substantially below its own revised finding of net liquidation value ($162,700,000) by the device of a "delay" discount and a "bulk sale" discount, neither of which has any validity or legal basis.

Such delay discount of $15,386,000 is supposed to be a "pricing out" of the Commission's alleged power to withhold an abandonment certificate for a year (thereby delaying the commencement of the six-year liquidation period) notwithstanding that, in view of its years of operating losses, the New Haven would be constitutionally entitled to liquidate without such abandonment certificate or at least would be entitled to receive it without delay.

The bulk sale discount of $6,695,000 proposed to be deducted from net liquidation value is simply an aberration. The Commission regarded it as a "pricing out" of its alleged power to compel a bulk sale of the New Haven assets (as opposed to permitting a sale in parcels), even to a purchaser who could immediately proceed to break up the railroad and sell its assets in parcels. This is absurd on its face. Moreover, the Commission deducted that discount even though all costs and expenses of the New Haven's program for liquidation sales in parcels over a six-year period had already been deducted in arriving at the net liquidation value found by the Commission.

The Commission in addition erroneously failed to credit the New Haven with any value for $5,600,000 of annual net income, being a portion the New Haven's partnership interest in the earnings of the New Haven's Grand Central hotels and office buildings which has been transferred to Penn Central.

The net liquidation value of the New Haven's assets as found by the Commission should also be increased (a) by $4,400,000 as the increase in the value of the New Haven's Harlem River and Oak Point Yards which is required by the record and (b) by the amount of $2,400,000 to correct the excessive discount to present worth which had been deducted by the Commission in arriving at net liquidation value.

The New Haven's inclusion in Penn Central having been delayed for the benefit of Penn Central for eleven months beyond the consummation of the Penn Central merger, the Commission erred (a) in limiting to $5,000,000 the amount of such losses to be reimbursed by Penn Central to the New Haven and (b) in failing to require Penn Central to reimburse New Haven for an additional $5,000,000 of such losses.

Finally, the formula intended to guarantee that the New Haven will receive a specified amount per share on the shares of Penn Central common stock which are included in the consideration received by the New Haven should be modified by eliminating the two conditions which might relieve Penn Central of further obligation under such formula without the New Haven's being assured of realizing such amount per share.

POINT I

The majority of the three-Judge Court erred in seeking to repudiate its initial ruling (and the ruling of the Reorganization Court) that liquidation value was the appropriate legal standard of valuation in this case.

(Questions 1, 2, 3, 4 and 5)

A. *The three-Judge Court purports to repudiate its earlier approval of the liquidation value standard but does not really do so.*

In holding in effect that the Commission was free in its valuation of the New Haven assets to refuse to follow any standard of value and that whatever figure the Commission picked should be accepted by the Courts provided only that the Commission has stated that such figure was considered by it to be fair and equitable (App. 404a-411a), the June 18, 1969 majority opinion of the three-Judge Court is in conflict not only with the minority of the three-Judge Court (Minority Opinion dated June 18, 1969, App. 431a) and with the Reorganization Court Opinion of May 28, 1969 (304 F. Supp. 793, App. 277a), but also is in direct conflict with its own prior July 10, 1968 opinion (289 F. Supp. at pp. 440-1, App. 359a-361a).*

The three-Judge Court in that first decision (289 F. Supp. at pp. 440-1, App. 359a-361a) ruled unanimously that "the proper legal standard" in this case was liquidation value and that "the price cannot be less than the liquidation value."

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* The June 18, 1969 holding of the majority is also in conflict with prior holdings of the Commission itself, later to be cited herein, to the effect that, in connection with the liquidation of a railroad line, the railroad was entitled to receive from a purchaser scrap value, i.e., liquidation value, as a minimum (e.g., *New York Central Acquisition of Chicago, Attica & S. R. Co.*, 187 I.C.C. 527, 549 (1932)).

In its later June 18, 1969 opinion, the majority of the three-Judge Court endeavored to evade this threshold issue as to "the proper legal standard" (App. 404a-411a) and in doing so necessarily intimated that the Commission might properly make a valuation finding without following any legal valuation standard.* In concluding its discussion of that subject, the majority opinion asserted (App. 410a) that, if the Commission made demonstrable errors, the Court should correct them. But the Court does not explain how it can be demonstrated that a valuation of a large railroad is erroneous if the Commission is not required to follow any standard of valuation or give a reasonable explanation of how it reached its result. Apparently, the majority would limit review to the correction of mathematical errors.

The "second round" opinion of the majority of the three-Judge Court indulges in strange and circuitous reasoning in its effort to get away from its earlier explicit ruling that the liquidation value standard should be followed in this case.

In line with its effort to jettison the initial opinion, the second opinion starts out with the statement (App. 406a) that it need not decide the issue whether the Commission was bound to award liquidation value. It then expresses the view (App. 407a) that liquidation value is not the appropriate standard, saying that it is anomalous for Penn Central to be required to pay liquidation value for the

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* This intimation that the Commission need follow no legal valuation standard appears in that June 18, 1969 opinion under the heading *"The Scope of Review and the Governing Standard"*. As will hereinafter more fully appear, the discussion under that heading will be searched in vain for the "Governing Standard" supposed to be set forth therein.

unprofitable New Haven since Penn Central could not liquidate the assets, but had to operate the line.*

Almost in the same breath, the opinion veers in the opposite direction and states (App. 407a-408a) that the three-Judge Court has previously decided pursuant to Supreme Court cases that the Fifth Amendment required a price of not less than liquidation value on the facts of this case; and the opinion announces that the majority still adheres to that view. As support for this holding, the opinion expressly adopts the reasons set forth in the May 28, 1969 opinion of the Reorganization Court, subject only to the qualification of requiring a §1(18) certificate from the Commission before liquidation could commence (App. 407a-408a).**

The three-Judge Court opinion having thus announced that the Court still adhered to its earlier view that the New Haven was entitled to a price not less than liquidation value immediately commenced another circular syllogism by proceeding to question the conclusion to which it just had said it adhered.

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* Clearly, there is no anomaly; as will hereinafter appear, the Commission has ruled in other cases that liquidation value is the minimum which must be paid under such circumstances.

** That §1(18) qualification was not contained in the three-Judge Court's first opinion which stated that the constitutional right of a deficit railroad such as the New Haven to cease operation and liquidate was not changed by the enactment of §1(18) or of §77 which "were not intended to override constitutional guarantees" (App. 359a-360a). The Reorganization Court in the May 28, 1969 opinion referred to by the three-Judge Court specifically stated that any abandonment proceeding in this case would be *pro forma* and should not take more than four to six weeks because the "New Haven had been studied, examined and reported on almost continuously since 1957" (304 F. Supp. at p. 797, App. 305a).

The majority opinion itself states that the New Haven would have been constitutionally entitled to issuance of such certificate "with appropriate speed" (App. 408a).

It commences this further argumentation by citing the Penn Central contention that the bondholders did not object in 1962 to the New Haven's being authorized by the Reorganization Court to apply for the option of inclusion (App. 409a). It then states that if it could take this Penn Central contention as indicating that inclusion was sought only because it would be more in the New Haven's interest than abandonment, nothing "would prevent the Commission's fixing a price considerably short of liquidation value" (App. 409a).

Not only is this contradictory to the preceding statements but it also an extraordinary *non sequitur*. It wholly overlooks the fact that what was involved as to the New Haven merely was whether the New Haven should be given an *option* to be included. Certainly, willingness to obtain such an option could not be a waiver of a right to reject the option when it was obtained and to seek instead to obtain liquidation value. Oddly enough, the majority opinion expressly recognizes this because it completes its second circle of oscillating views by saying in so many words that if the option price which was fixed by the Commission was considerably short of liquidation value, the New Haven was "free to refuse and seek the abandonment to which you [the New Haven] are entitled" (App. 409a).

Having thereby flatly nullified its supposition (made for the purpose of argument) that the history of the proceeding might require the New Haven to accept substantially less than liquidation value, the opinion proceeds further to undercut that supposition by reciting some of the history of the proceeding adverse to the supposition and by concluding that § 5(2)(d) might therefore require at least a close approach to liquidation value even if the Fifth Amendment did not (App. 409a-410a).

Thus, after circling several times all around the issue as to a valuation standard, dropping inconsistent rulings on the way, the reasoning of the majority opinion concerning the Fourth Supplemental Report essentially leaves untouched the prior ruling that the New Haven is entitled to receive at least liquidation value. But the majority winds up its vacillating discussion by saying that the two-Judge majority did not "feel called upon finally to decide these intriguing issues" (App. 410a)—issues which it had no difficulty in deciding on the first round.*

The dissenting Judge and the Reorganization Court have been consistent from the beginning in their view that the liquidation value standard was applicable in the present case. We submit that the consistent views of these two Judges are entitled to greater weight on this issue than the equivocal views of the two Judges forming the majority.

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* Support for our view that, despite its protestations, the two-Judge majority did wind up by upholding liquidation value as the valuation standard applicable in the present case appears in the Solicitor General's January 1970 Memorandum filed in this Court in which it is stated (p. 7) that the three-Judge Court as well as the Reorganization Court "accepted the same basic criterion for pricing the New Haven properties—their liquidation value as of an appropriate date".

B. *The unanimous original holding of the Courts below that the appropriate standard of valuation in this case was liquidation value was correct.*

(i) The history of this case supports the applicability of the liquidation value standard to determine the minimum price.

Until the Commission in its Fourth Supplemental Report found a liquidation value of $162,700,000 but held that it need not fix the price at that amount because it was not bound to apply the liquidation value standard (or any standard of valuation), there appeared to be no dispute that liquidation value was the applicable standard.* The Penn Central executives advocated the asset value standard in their 1964 negotiations with the New Haven Trustees.**

The New Haven Trustees have consistently taken the position in these proceedings that liquidation value is the minimum price. The creditor interests who participated in the Commission hearings regarding the terms of New

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* Liquidation value, as referred to above, includes the New Haven's partnership interest and rights in respect of the Grand Central properties (later herein to be discussed) which would be retained by it upon liquidation notwithstanding that the New Haven would then cease to use Grand Central Terminal.

** The Penn Central representatives and the New Haven Trustees agreed in their negotiations that the price should be determined basically by asset valuation. Both New Haven Trustees so testified (Ex. NHI-1, pp. 21, 28-29; Ex. NHI-65, p. 16). In the decisive meeting between Penn Central representatives (Messrs. Saunders and Grant) and the New Haven Trustees on November 12, 1964, Mr. Saunders' initial statement (Ex. NHI-9, p. 1) was that price should be basically determined on consolidated book values. This is further confirmed in the same memorandum (Ex. NHI-9, p. 3) in which Mr. Saunders and Mr. Grant are stated to have indicated that they computed a liquidating value of about $128,000,000 for the New Haven and that they computed the total cost of the consideration then being offered by them, together with equipment obligations and other costs they would bear, to be about the same amount. [The Exhibits referred to above are included in Document Nos. 118 and 120 of the three-Judge Court record.]

Haven's inclusion all took that position. Essentially, the Commission also took that position in its Second Supplemental Report.

As early as 1965 the Reorganization Court was warning that continued erosion of the bondholders' interest by reason of operating losses could not continue for long without violating the Fifth Amendment; and that such continuance would in time entitle the creditors to move for and obtain liquidation.* Obviously, such a liquidation would produce liquidation value for the New Haven and its bondholders.

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* For example, the Bankruptcy Court said in an opinion dated February 15, 1965, in authorizing an application to the Commission for discontinuance of the New Haven's passenger service:

> "Those to whom is granted a public monopoly, compensatory in the main, can reasonably be expected to absorb the burdens of certain incidents of the monopoly. But no construction of due process will permit this court to require that the creditors of this estate witness the continuing erosion of their security without the slightest prospect of relief.
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> "If this tax burden continues to grow and the Railroad is not otherwise relieved, the creditors will be compelled to move for liquidation of the New Haven and the Court will have no recourse but to order it."

Again in an oral opinion rendered by the District Court in the bankruptcy proceeding on June 25, 1965, the Court said in answering the suggestion that the "public interest is everything".

> "The public interest is not everything. The public interest is certainly something that must be considered. But the public has no more right to take without compensation the property that belongs to the creditors than they have to take a person's home or his bank account or his automobile or any other property that an individual owns, without compensation. There is a constitutional prohibition against it. And regardless of what officials may say or what statutes there may be, we cannot forget the fact that the Constitution says that no property shall be taken without just compensation."

Mr. Tucker (then Vice Chairman of the Commission) in his April 6, 1966 opinion said (327 I.C.C. at pp. 550-1) that, if not for the New Haven's unification with Penn Central, it "might face liquidation".

Following efforts (eventually unsuccessful) to require Penn Central to include the New Haven at the time of the Penn Central merger, bondholder interests moved in the Reorganization Court in April 1967 for leave to liquidate the New Haven and thereby realize liquidation value. In an opinion dated February 11, 1968, the Reorganization Court denied that application because "the prescribed steps under §77 of the Bankruptcy Act have reached their final stages and a plan of reorganization under the Act has been found to be feasible, and a specific plan has been approved and is about to be certified to this court" (App. 235a). The Reorganization Court further stated that the creditors could present their constitutional claims in the further Court proceedings. Later, the Reorganization Court in its August 10, 1968 opinion made the following ruling (289 F. Supp. at p. 459, App. 245a):

> "The extent to which the constitutional minimum of value of property rights to which the bondholders are entitled (in this case the liquidation value as of December 31, 1966) may properly be invaded in the public interest to keep railroad operations going pending a solution of the problem of reorganization, is hardly a matter which can be determined with mathematical precision. It involves a consideration of the amount and nature of the Railroad's obligations, the seriousness of adverse consequences to the public if service were terminated, the rate of losses and the feasibility of possible solutions. In view of the history of this deficit operation from the time of the filing of

the petition under §77 and even before, the size of the losses, the long period of time necessarily involved in seeking to work out a solution, short of liquidation, through inclusion in the Penn-Central, the present condition of the Railroad and the rate of loss and out-flow of cash in the recent past and in the foreseeable future, this court finds that the continued erosion of the Debtor's estate from operational losses after the end of 1968 will clearly constitute a taking of the Debtor's property and consequently the interests of the bondholders, without just compensation. It is therefore constitutionally impermissible, and obviously no reorganization plan which calls for such a taking can be approved."*

The Commission has not really questioned that, if it is bound to follow a legal standard of liquidation, the liquidation value standard is the one which was here applicable. Its contention has been that it is not bound to follow any legal standard and that its *ipse dixit* that its result is fair

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* It is to be noted that the Reorganization Court here holds that the constitutional minimum of value to which the bondholders are entitled is liquidation value. Earlier in the same opinion (App. 239a) the Court had likewise ruled that liquidation value was the minimum and had continued "This is so not because the Constitution necessarily requires it but because that standard, under the circumstances of this case, is fair both to the creditors and to the Penn-Central". In its later May 28, 1969 opinion on the second round, the Reorganization Court stated specifically (304 F. Supp. at pp. 798-9, App. 281a) that the Reorganization Court (and the three-Judge Court) in their initial opinions had decided that in this case the only feasible standard for determining price "must, because of both the 'fair and equitable' clauses of the statutes and the constitutional mandate, be the fair liquidation value . . .".

Similarly, the three-Judge Court in its initial opinion referred (289 F. Supp. at p. 440, App. 359a) to "the constitutional right of NH to cease operation and liquidate" and stated (289 F. Supp. at p. 441, App. 361a) that its view was "that the price cannot be less than the liquidation value . . .".

and equitable is all that is needed to validate that result.* To support that proposition, the Commission has cited *Federal Power Com'n* v. *Hope Natural Gas Co.*, 320 U. S. 591, 602 (1944) for the holding "that the Commission was not bound to the use of any single formula or combination of formulae in determining rates" (App. 143a-144a). But these words of the Supreme Court do not mean what the Commission wants them to mean, namely, that the Commission need follow *no* formula or standard but need only opine that the result is "just and reasonable" or "fair and equitable".

In the *Hope* case, the Court held that, for rate-making purposes, the Federal Power Commission need not use a "fair value" base** but instead was entitled to follow the standard that there be enough revenue to meet operating expenses and capital costs and a return on equity sufficient to maintain the credit of the enterprise and to attract capital (320 U. S. at p. 603). This did not free the Commission from following an appropriate standard for rate-making

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* As to such a contention by the Commission, the Reorganization Court said in its May 28, 1969 opinion (304 F. Supp. at p. 799, App. 282a):

> "The Commission also asserts that, because the Constitution does not specify any particular method of valuation, it possesses unrestricted flexibility and range of discretion; and 'due process' and 'just compensation' referred to in the Fifth Amendment mean compensation based upon the value of the assets remaining after the debtor's estate has been invaded to the unlimited extent the Commission finds is called for by the paramount public interest, provided the Commission takes pains to declare it fair and equitable. This is tantamount to no constitutional protection whatever."

** Perhaps the Commission hoped to suggest, without going so far as expressly to contend, that since "fair value" was eliminated by the *Hope* case as the standard for rate-making, likewise no valuation of New Haven assets is needed in the present case. It is not surprising this contention is not stated because it would so obviously be without merit.

purpose, on the contrary, it simply approved the substitution of another standard for the fair value standard theretofore used.

Many later cases show that this Court has required the Federal Power Commission in rate-making cases to adhere to legal standards and to explain its results so that it may be determined whether the results are reasonable and have a substantial basis in the record. (See, for example, *Permian Basic Area Rate Cases*, 390 U. S. 747 (1968) in which opinion, at pp. 791-2, there is set forth an extended statement of responsibilities of the reviewing Court. Also, in proceedings involving internal §77 reorganization plans, the Commission's valuation will be upheld only if it "is reached with material evidence to support the conclusion and in accordance with legal standards" (*Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448, 473 (1943)).

(ii) Under the Constitution and the controlling authorities, the undisputed inability of the New Haven, after years of deficit operations, to conduct further operations except at large losses entitles it to discontinue such operations and realize the liquidation value of its assets.

We turn now to a discussion of authorities which demonstrate that the New Haven and its bondholders after years of operating losses would have the constitutional right to discontinuance of the loss operation and are therefore entitled to have the New Haven assets valued by application of the legal standard of liquidation value as was unanimously held in the initial decisions of all the Judges below.

There can be no question but that the bankruptcy power and the commerce power are subject to the Fifth Amendment. Thus, this Court said in *Louisville Bank* v. *Radford*,

295 U. S. 555 (1935), at p. 589: "The bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment." And in *Monongahela Navigation Co.* v. *United States,* 148 U. S. 312 (1893), this Court said as to the commerce power (p. 336):

> "But like the other powers granted to Congress by the Constitution, the power to regulate commerce is subject to all the limitations imposed by such instrument, and among them is that of the Fifth Amendment, we have heretofore quoted. Congress has supreme control over the regulation of commerce, but if, in exercising that supreme control, it deems it necessary to take private property, then it must proceed subject to the limitations imposed by this Fifth Amendment, and can take only on payment of just compensation."

In that leading case, this Court also held that the Fifth Amendment protection for the security of person and property should be liberally construed, quoting (148 U. S. at p. 325) from *Boyd* v. *United States,* 116 U. S. 616, 635 (1886) as follows:

> "'Illegitimate and unconstitutional practices get their first footing in that way, namely, by silent approaches and slight deviations from legal modes of procedure. This can only be obviated by adhering to the rule that constitutional provisions for the security of person and property should be liberally construed. A close and literal construction deprives them of half their efficacy, and leads to gradual depreciation of the right, as if it consisted more in sound than in substance. It is the duty of courts to be watchful for the constitutional rights of the citizen, and against any stealthy encroachments thereon.'"

In *Olson* v. *United States*, 292 U. S. 246 (1934), the Court said (pp. 254-5) with regard to the *Monongahela* decision:

> "The statement in that opinion (p. 326) that 'no private property shall be appropriated to public uses unless a full and exact equivalent for it be returned to the owner' aptly expresses the scope of the constitutional safeguard against the uncompensated taking or use of private property for public purposes."

This Court has also held that the due process clause of the Fourteenth Amendment protects a railroad from being required to continue its operations where there is reasonable certainty that future operations must be at a loss and that in such situation the railroad is entitled to realize upon salvage value. *Railroad Commission* v. *Eastern Texas Railroad*, 264 U. S. 79 (1924) involved an intrastate railroad built in Texas to serve lumbering industries adjacent to a supply of timber which, in the course of time, was exhausted, resulting in a traffic reduction for the railroad sufficient to decrease revenue below the cost of operation. The Court there said (p. 85):

> "The usual permissive charter of a railroad company does not give rise to any obligation on the part of the company to operate its road at a loss. No contract that it will do so can be elicited from the acceptance of the charter or from putting the road in operation. The company, although devoting its property to the use of the public, does not do so irrevocably or absolutely, but on condition that the public shall supply sufficient traffic on a reasonable rate basis to yield a fair return. And if at any time it develops with reasonable certainty that future operation must be at a loss, the company may discontinue operation and get what it can out of the property by dismantling the road. To

compel it to go on at a loss or to give up the salvage value would be to take its property without the just compensation which is a part of due process of law. The controlling principle is the same that is applied in the many cases in which the constitutionality of a rate is held to depend upon whether it yields a fair return. *Brooks-Scanlon Co.* v. *Railroad Commission of Louisiana,* 251 U. S. 396, 399; *Bullock* v. *Railroad Commission of Florida,* 254 U. S. 513, 520; *State ex rel. Cunningham* v. *Jack,* 113 Fed. 823; s. c. 145 Fed. 281; *Iowa* v. *Old Colony Trust Co.,* 215 Fed. 307, 312; *Northern Pacific R. R. Co.* v. *Dustin,* 142 U. S. 492, 499; *Commonwealth* v. *Fitchburg R. R. Co.,* 12 Gray, 180, 190; *State* v. *Dodge City, etc. Ry. Co.,* 53 Kan. 329, 336."

The Fifth Amendment cannot be any less effective in protection of the rights of New Haven creditors in the present case than was the Fourteenth Amendment in protecting the rights of the intrastate railroad involved in the above case.

There are other cases with similar holdings. In *Erie Railroad Company* v. *Board of Public Utility Commissioners,* 254 U. S. 394 (1921), it was held that a state might require a railroad company to do away with grade crossings but (p. 411) "If the burdens imposed are so great that the road cannot be run at a profit it can stop, whatever the misfortunes the stopping may produce".

Again, in *Bullock* v. *Railroad Commission of Florida,* 254 U. S. 513 (1921), the Court said at p. 521:

"Without previous statute or contract to compel the company to keep on at a loss would be an unconstitutional taking of its property".

Likewise, in *Brooks-Scanlon Company* v. *Railroad Commission of Louisiana*, 251 U. S. 396 (1920), the Court said at p. 399:

> "If the plaintiff be taken to have granted to the public an interest in the use of the railroad it may withdraw its grant by discontinuing the use when that use can be kept up only at a loss."

Thereafter in *Fort Smith Traction Co.* v. *Bourland*, 267 U.S. 330 (1925), Mr. Justice Brandeis speaking for the Court said (p. 333) that a railway "cannot, in the absence of contract, be compelled to continue to operate its system at a loss", citing the *Brooks-Scanlon* case.

In *Pacific Tel. Co.* v. *Tax Com'n*, 297 U.S. 403 (1936), Mr. Justice Brandeis again speaking for the Court made a similar statement, likewise citing *Brooks-Scanlon*.

In a more recent case, *Northwestern Pacific Railroad Company* v. *United States*, 228 F. Supp. 690 (three-Judge Court, S.D. Cal. 1964), *aff'd per curiam*, 379 U.S. 132 (1964), the three-Judge Court after referring to *Southern R. Co.* v. *North Carolina*, 376 U.S. 93 (1964) concluded (p. 694) that, under that decision, no confiscation would result from denial of abandonment of part of a railroad unprofitably operated so long as there was no net loss for the entire system, the corollary necessarily being that there would be such confiscation if there were an over-all system loss.

It was also held in *Pittsburgh & Shawmut Coal Co.* v. *Delaware & N. R. Co.*, 289 Fed. 133 (N.D.N.Y. 1923), that an entire road may be abandoned if operated at a loss and (p. 134) that "This right of abandonment, being constitutional in its nature, cannot be impaired by subsequent legislative enactment, either federal or state".

In *Continental Bank* v. *Rock Island Ry. Co.*, 294 U. S. 648 (1935), this Court rejected the contention that the

Fifth Amendment invalidated a Section 77 injunction against a sale of collateral by creditors who claimed that the injunction deprived them of their property without due process of law. This Court's ruling rested on the basis that the injunction affected only their remedy and not their substantive rights (pp. 681, 685), thus making it clear that the substantive rights of railroad creditors are entitled to constitutional protection.* The burden of losses as endured by New Haven creditors during the years of the Section 77 proceeding has been very severe and they are entitled to Fifth Amendment protection against further confiscation.

The notion that property can be taken for public use without compensation merely "because the public wanted it very much" was condemned in *Pennsylvania Coal Co.* v. *Mahon,* 260 U. S. 393 (1922), where the Court, through Mr. Justice Holmes, said (pp. 415-16):

> "The protection of private property in the Fifth Amendment presupposes that it is wanted for public use, but provides that it shall not be taken for such use without compensation. A similar assumption is made in the decisions upon the Fourteenth Amendment. *Hairston* v. *Danville & Western Ry. Co.,* 208 U. S. 598, 605. When this seemingly absolute protection is found to be qualified by the police power, the natural

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* In *In re New York, New Haven & Hartford R. Co.,* 147 F.2d 40 (2d Cir. 1945), *cert. denied* 325 U. S. 884 (1945), creditor banks had been enjoined from selling collateral securing notes of the debtor and the collateral became worthless during the pendency of the proceeding. However, the Court protected the creditors from the damage caused by its injunction by holding (p. 48) that they should be treated as secured creditors to the extent they could have realized on their collateral if not for the injunction. In the present case, the bondholders have been restrained by injunction from enforcing their liens and should similarly receive protection through valuation of the New Haven assets on the basis of not less than their liquidation value.

> tendency of human nature is to extend the qualification more and more until at last private property disappears. But that cannot be accomplished in this way under the Constitution of the United States. • • •
>
> "We are in danger of forgetting that a strong public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying for the change."

In the Fourth Supplemental Report the Commission argued that the rationale of *Brooks-Scanlon* (251 U. S. 396 (1920)), *supra*, was overruled *sub silentio* by *Colorado v. United States*, 271 U. S. 153, 166, 168 (1926). The Reorganization Court effectively refuted that contention in its May 28, 1969 opinion (304 F. Supp. at pp. 802-4, App. 286a-291a); and the Commission itself has recently recognized the continued vitality of the *Brooks-Scanlon* doctrine. The Commission said in *Tennessee Central Ry. Co. Abandonment*, 333 I.C.C. 443 (1968) at page 452:

> "It is well established that a carrier should not be required to continue in the business of carriage when its overall operations are conducted at a systemwide deficit for a substantial period of time and where there is no reasonable prospect of the applicant's conducting those operations at a profit for the foreseeable future. Compare *Brooks-Scanlon Co.* v. *Louisiana R. Comm.*, 251 U. S. 396 (1920), and *Chicago N. S. & M. Ry. Abandonment of Entire Operation*, 317 I.C.C. 191 and 363."

Other Commission cases hold that, whether on Fifth Amendment grounds or on statutory grounds ("fair and equitable"), the Commission will provide for continued operation by a purchaser of a railroad line which is being abandoned only if the purchaser pays the owner at least net salvage value (*i.e.*, liquidation value). Thus, in footnote 35

of the Fourth Supplemental Report (App. 147a), the Commission states that:

> "In many cases we have imposed the condition that the carrier shall sell segments of the line at not less than net salvage value to a prospective buyer for continued operation before dismantling the line".

One of such cases, *New York Central R. Co. Acquisition of Boyne City, G. & A. R.*, 180 I.C.C. 538 (1932), is, in principle, remarkably similar to the present case. The Central had applied for approval by the Commission under Section 5(2) of its acquiring control over other common carriers and its application was approved on the condition, among others, that Central offer to acquire the Boyne City line (called Alpena) for its commercial value. Central argued that the Alpena was a deficit line and had at best a nominal commercial value of $1. However, the Commission said (p. 564) that a deficit railroad was not worthless "unless it is also impossible to put it to some other profitable use and impossible to realize upon its scrap value". Central then argued that since the Commission had found that preservation of the Alpena line was required by public convenience and necessity the Alpena owners could not realize the scrap value. This argument was also rejected with the statement (p. 565) that "In the absence of special contract provision in its charter, denial of a railroad's right to abandon operations and realize on the salvage value of the property, if it appears reasonably certain that future operations will be at a loss, would amount to confiscation".

In another similar case, *New York Central Acquisition of Chicago, Attica & S. R. Co.*, 187 I.C.C. 527 (1932) the Commission said (p. 549): "Proof in this instance that the owners of the Attica can realize a substantial sum by scrap-

ping the property fixes the commercial value at not less than that amount."

Likewise, in *Tennessee Central Ry. Co. Abandonment*, 333 I.C.C. 443, 455 (1968), *supra*, the Commission provided that the line being abandoned, or parts thereof, would be sold to any purchaser who would continue operation but that the price should be "not less than the net salvage value of the property sought to be acquired".

The Commission in its Fourth Supplemental Report cites (App. 143a) *In re Chicago, R. I. & P. Ry. Co.*, 50 F. Supp. 835 (N.D. Ill. 1943), *aff'd* (on other issues) 157 F. 2d 241 (7th Cir. 1946), *cert. denied*, 329 U.S. 780 (1946), in support of its contention that the New Haven, despite its hopeless deficits, would not have the right to liquidate the railroad and obtain salvage value. The case is not in point. There was no proposal before that Court to discontinue operation of the unprofitable division involved, the railroad system being profitable as a whole. What the District Court said was that the net salvage value of the division did not have any bearing on the amount of new securities which the bonds secured by the deficit division were entitled to receive out of the new securities to be issued in an internal reorganization (50 F. Supp. at p. 862). However, that District Court also said that "It cannot be denied that the BCR&N [the deficit division] is an asset to the system, or claimed that the lines should be abandoned. . . ".

It is apparent that the operating deficits of that division were being borne by the profitable railroad system rather than by the particular deficit division itself. Despite the fact that the division had deficit earnings, the bondholders having a lien on the division were allotted (50 F. Supp. at p. 848) in the reorganization plan a substantial amount of new income bonds, preferred stock and common stock of the reorganized system which would necessarily be a reflec-

tion of the railroad system's need for its continued use of the deficit division. There was no desire or request by the bondholders of the division for discontinuance of its deficit operations; therefore, they must have deemed that they fared better by obtaining the allocation of new securities, particularly if they could get the allotment increased. The issue was whether, in view of the need of the continuing railroad system for the deficit division, additional new securities should be allotted to that division's bondholders; and when such increase was denied them, they did not even prosecute an appeal.

The appellees may refer to the following statement of this Court in its *Penn-Central Merger* opinion (389 U.S. at pp. 510-511) which accompanied its ruling that the Penn Central merger should not be delayed "until all proceedings necessary to include the NH had taken place":

> "While the rights of the bondholders are entitled to respect, they do not command Procrustean measures. They certainly do not dictate that rail operations vital to the Nation be jettisoned despite the availability of a feasible alternative. The public interest is not merely a pawn to be sacrificed for the strategic purposes or protection of a class of security holders whose interests may or may not be served by the destructive move."

The Court went on to point out that the bondholders' objections should first be passed on by the Reorganization Court or a statutory District Court. Thus, its remarks were not addressed in any way to the merits of the objections to the provisions of the Commission's Second Supplemental Report. On the contrary, they serve to emphasize the need, in the public interest, for the continued operation of this railroad line—a need which nevertheless must be met with due

regard to the right of the bondholders to be protected from confiscation of their property.

Unless constitutional protection is here afforded, the creditors' substantive property rights (already eroded to a large extent) will be destroyed. Persons who have invested (and those who hereafter invest) in railroad securities would be left in a position where they have no constitutional protection. This would not only violate the Constitution but would be destructive of the transportation system which, as this Court has stated, must look for its preservation to private investment of funds in railroad securities. In *Group of Investors* v. *Milwaukee R. Co.*, 318 U.S. 523 (1943), this Court emphasized (p. 544) that the "preservation of the transportation system and the stability of its credit essential to its preservation depend not alone upon the ability of individual carriers to meet their obligations, but upon the ability of all to attract the investment of funds in their securities".

We should add that the unanimous holding on the initial review that liquidation value was the proper valuation standard here should have been adhered to thereafter by the three-Judge Court as the "law of the case". The Reorganization Court expressly so held (May 28, 1969 Opinion, 304 F. Supp at p. 801, App. 286a).* The thrust of the June 18,

* The "law of the case" doctrine is not inflexible but it is nevertheless an important legal principle. As was stated in *Southern Ry. Co.* v. *Clift*, 260 U.S. 316 (1922) at p. 319, the difference between the law of the case doctrine and *res judicata* is that "one directs discretion, the other supersedes it and compels judgment".

The law of the case rule was given effect in *Zdanok* v. *Glidden Company, et al.*, 327 F. 2d 944 (2d Cir. 1964), *cert. denied*, 377 U.S. 934 (1964), in an opinion by Judge Friendly. The opinion stated (p. 953) that "where litigants have once battled for the court's decision, they should neither be required, nor without good reason permitted, to battle for it again". That opinion further stated that a clear conviction of error on a point of law may "prevail over 'the law of the case' whereas 'mere doubt' will not".

1969 opinion of the minority of the three-Judge Court is to the same effect. Indeed, the dissenting Judge takes the position (App. 434a *et seq.*) that the majority in the opinion of the same date adheres to the liquidation value standard and that the error of the majority lies in accepting large deductions which unjustifiably reduce liquidation value and the price.

C. *The majority of the three-Judge Court erroneously approved the Commission's imposition on the New Haven of part of the future operating deficits of the New Haven by means of a deduction on this account from the liquidation value and the price.*

As a result of the initial holding of both Courts that liquidation value was the appropriate legal standard and that liquidation value and the price approved by the Commission fell far short of that standard, both Courts remanded the proceedings to the Commission. The three-Judge Court opinion in addition suggested (App. 361a) that, if the Commission did not agree with the Court's view as to the applicability of the liquidation value standard it (a) should nevertheless make findings as to the result of properly applying such liquidation standard and (b) also should "state the pricing theory it has adopted, the reasons for it, and the results, and shall make whatever detailed subsidiary findings are required to support this" (289 F. Supp. at p. 441, App. 361a).

The Commission, obviously determined to make a valuation finding as close as possible to the purchase price it had originally approved,* seized upon the above-quoted

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* In its original determination as to the consideration, the Commission failed to perform its duty to arrive at an independent judgment as to the price instead of merely adopting the agreement (not approved by any Court) between Penn Central and the New Haven Trustees. As was said in *In re New York, New Haven &*

suggestion of the three-Judge Court as a means of fixing a price in its Fourth Supplemental Report which would be far less than liquidation value. In doing so, it did not produce an alternative pricing theory as the Court had stated it might do. Instead, having produced a revised valuation of $162,700,00 based on the liquidation value standard (an increase of $37,700,000 over its original $125,000,000 liquidation value finding), the Commission refused to award that amount to the New Haven.

It appears to us that the basic reason stated and reiterated by the Commission for refusing to give effect to its revised finding of net liquidation value was that Penn Central would not be able to realize such net liquidation value by sale because it would be obligated to continue the

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Hartford R. Co., 147 F.2d 40 (2d Cir. 1945), *cert. denied*, 325 U. S. 884 (1945), at p. 49:

> "Section 77 requires an independent determination by the Commission that the plan is 'fair and equitable'. The heart of such a determination is a finding of fact by the Commission as to the value of the debtor's property. It follows that that finding cannot be based upon the consent of some of the interested parties but must be a conclusion independently reached by the Commission upon a consideration of the evidence . . . we cannot doubt that the Commission must approve the plan in the exercise of an independent judgment uninfluenced by the fact that interested parties have agreed upon its terms."

Nevertheless, in the present case, the Commission not only adopted originally the price specified in the aforesaid purchase agreement (as well as the agreement's other provisions) but in doing so it concededly gave that agreement "some probative force as to the values of the properties involved" and said that the "negotiated price" (representatives of the New Haven creditors were not allowed to participate in such negotiations) could well be above the minimum to which the creditors were entitled (331 I.C.C. at p. 657, App. 15a). It is apparent that from the outset the Commission was predisposed toward approval of the tentative purchase agreement; it was no mere coincidence that what the Commission originally approved as a fair price happened to be the price embodied in that agreement.

deficit New Haven operation in the public interest.* The argument was that if Penn Central could not realize net liquidation value then the New Haven was not entitled to do so either and that the price which Penn Central should pay to New Haven should take into account the burden to Penn Central of its assumption of the New Haven deficit operation.**

Thus, in its Fourth Supplemental Report, the Commission flouted the holdings of both Courts that the New Haven and its creditors were constitutionally entitled to receive liquidation value. It said (334 I.C.C. at p. 54, App. 141a) that the liquidation value price was

> "wholly inconsistent with the requirement we have imposed on Penn Central to absorb the NH, which requirement rests entirely upon the public's need for a continuing NH. Any assumption that NH may be shut down and broken up must necessarily permit the con-

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* The three-Judge Court had unanimously answered that contention of the Commission in the Court's initial opinion by saying (289 F. Supp. at p. 441, App. 360a-361a) that "when the asking price for the acquired road is what the Constitution demands the owners must receive as a condition to allowing the road to be operated in the public service, we think—subject only to what we shall say hereafter as to interim losses—that the Commission may not fix, or approve, anything less". This may be contrasted with the volte-face statement of the two-Judge majority in its later opinion (App. 407a) that there is "a decided anomaly in the position that, looking only at the words of the statute, the Commission was required to make PC pay a price for NH which is far beyond anything NH is worth to it in an economic sense and which, by hypothesis, it can never realize".

** Having announced that the liquidation value price should be reduced on account of the burden of Penn Central's continuing the New Haven deficit operation, the Commission then implemented that view (and sought to bring the purchase price down toward the amount it had originally approved) by adopting two new unjustified discounts to be deducted from the $162,700,000 liquidation value. These discounts will be discussed in the following Point II.

clusion that Penn Central may be relieved of its inclusion obligation. It is inequitable to conceive at the same time both a right in the bondholders to break up the NH and an obligation on Penn Central to keep it going. The demands of equity are no more satisfied by conceiving that the bondholders have a constitutional right to shut down the NH which is superior to the public's right to keep it going".

In the same vein, the Commission in that Report, after referring to the burden on Penn Central of future operating losses of the New Haven line, stated (334 I.C.C. at p. 66, App. 153a) that it was unfair to Penn Central to pay liquidation value for the New Haven assets since it was "not free to liquidate and must continue the operation of the property in the public interest". At other points in the Fourth Supplemental Report, the Commission also refers to the burden of future New Haven operating losses which it is imposing on Penn Central (*e.g.*, 334 I.C.C. at p. 67, App. 154a).

The above and other references in the Fourth Supplemental Report to the public need for, and the public interest in, continued New Haven services represent an effort to justify a substantial reduction in the price payable by Penn Central to the New Haven below liquidation value in order to reduce the burden of Penn Central's acquisition of the deficit New Haven operation. That effort is not only contrary to law, as hereinbefore set forth, but it also is plainly unfair and inequitable to the New Haven and its creditors.

In the first place, there is no equity in the Penn Central plea, or a Commission effort, to relieve the Penn Central of part of the burden of future New Haven deficit operations by transferring it to the New Haven. In order to

effect its own merger, Penn Central agreed to comply with the condition that the New Haven be included.* It could not have been compelled to merge and include the New Haven. It was free to reject the condition and abandon the Penn Central merger. Not having done so, it is fair and equitable that it pay the price**—and the price must

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* Nor was it strange that Penn Central was willing to accept the condition regarding the New Haven in order to effect its own merger. The Penn Central Merger Report (327 I.C.C. 475 (April 6, 1966)) found that after a Penn Central program of extensive capital improvements scheduled over a four-year period (pp. 489-90) and after further benefits from the merger "Applicants [Penn and Central] have shown that their annual savings from the merger will exceed $80 million after about eight years. See pp. 131-155 of the initial report." (pp. 501-2). The reference to the initial report is to the Examiners' discussion of savings which included the following finding that there would be greater total savings (Mimeo, p. 142):

> "Though we agree with N.H. that savings of a greater total amount than projected should eventually inure to the merged system, whether the total amounts to $85 million or $100 million is not too important in our assessment of the issues nor as later will be discussed do we believe it would alter conclusions with respect to our proposed conditions relative to the N.H. or any other carrier involved in this proceeding."

In the Second Supplemental Report (331 I.C.C. at p. 688, App. 46a) the Commission stated that it had approved the Penn Central merger "with the thought that some of the merger savings would be available specifically to ward off a liquidation and shutdown of the NH so that adequate transportation service would remain available to the public which now relies on the NH". Nevertheless, the Commission, ignoring the erosion of the New Haven assets over many past years of deficit operations, unfairly seeks also to weigh the New Haven bondholders down with, and to relieve Penn Central correspondingly from, part of the burden of future deficit operations.

** At the argument in this Court of the Penn Central Merger case, Penn Central counsel, in answer to questions put to him by the Court, acknowledged that, upon consummation of the Penn Central merger, Penn Central would be obligated to pay whatever price the Commission and the Courts might find reasonable, whether originally or on remand to the Commission (App. 247a-248a).

include the liquidation value of the New Haven assets it acquired.

Second, had Penn Central not made the New Haven commitment in order to obtain something it regarded as of great value, the New Haven could not have been kept alive; it would have ceased operation long ago for lack of funds as soon as the Penn Central merger was dropped; and liquidation value would thereupon have been realized for its assets.*

Third, to reduce the price payable to the New Haven on account of expected future deficits to be incurred upon the continuance of New Haven operations by Penn Central would be to fasten part of that burden on the New Haven for all time. It would indeed be anomalous for the New Haven to have the constitutional right to discontinue operations and obtain salvage value because of its substantial operating deficits over past years and at the same time fasten on the New Haven part of the burden of future operating deficits.**

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* As early as 1962 (printed Court Record p. 700 (30-31)), the New Haven Trustees announced the necessity of its being merged with a trunk line railroad (which could only be Penn and/or Central); and obviously the choice was between such a merger and liquidation.

** The Commission, in its first decision (Second Supplemental Report) determining the consideration, did not make any deduction from liquidation value on account of the obligation of Penn Central to continue a losing New Haven railroad operation.

D. *The present proceeding is analogous to a condemnation proceeding; the New Haven's property has been taken for a public purpose and Penn Central should pay the liquidation value of that property as the equivalent of a condemnation price.*

The 1969 opinion of the majority of the three-Judge Court states that the just compensation and due process clauses of the Constitution are triggered only by governmental action (App. 408a). The opinion does not go on to deny that governmental compulsion was exerted here to transfer the New Haven assets to Penn Central for continued operation by it. The opinion merely says (App. 409a) that Penn Central has argued "that although the bondholders seek compensation for governmental taking of a right to liquidate, they never properly asserted such a right." Continuing equivocally, the opinion thereupon indicates (App. 409a-410a) that this was not a valid objection because "the proper administration of §5(2)(d) may require at least a close approach to what they [the bondholders] could have realized in an assumed liquidation even though, because of the absence of an actual taking or other governmental compulsion, the Fifth Amendment does not". Then the opinion states that that Court need not decide the question.*

It is clear that there was governmental compulsion here. The Commission repeatedly found (and it is not disputed by anyone) that there was an urgent public need for continued New Haven service. Therefore, the Commission compelled Penn Central to satisfy that need or drop its own merger. Penn Central for a commercial purpose (*i.e.*,

* Along the way, the opinion states that the bondholders say, with considerable force, that the "known attitude of the Commission was the practical equivalent of the denial of an application for abandonment and entailed an obligation to procure for them what they could have realized on abandonment if inclusion became a reality". (App. 410a)

to effect its own merger) agreed to acquire the New Haven assets and continue its operation.

The Commission has made it clear that it was the public need which prevented the New Haven from being shut down and its assets liquidated. It said that the Commission has imposed on Penn Central the requirement of absorbing the New Haven, "which requirement rests entirely upon the public's need for a continuing NH" (334 I.C.C. at p. 54, App. 141a). The Commission also said that, in view of its finding that there was a public need for the railroad, the creditors may not liquidate the New Haven or devote the properties to another use (334 I.C.C. at p. 55, App. 142a). Again, the Commission said (334 I.C.C. at p. 61, App. 148a) "Even if not necessary in the private interest, where there is no longer a going concern value to preserve, the public need for the rail service may require its preservation as a going concern."

Accordingly, Penn Central was the instrumentality chosen by a public authority (the Commission) to continue the operation of the railroad in the public interest and to block New Haven's right to liquidate and thereby to obtain liquidation value. This was no less than a condemnation by means of Penn Central.

The Special Master (John Van Voorhis, a retired New York Court of Appeals Judge) recognized that there was here involved a transaction in the nature of a condemnation of the New Haven. He said (June 17, 1968 Report,* p. 45):

> "in a number of respects, it is analogous thereto," and further: "this amounts in reality (whether or not it does in name) to a taking of the property of the bondholders without their consent. This is not a proceeding in the Court of Claims but the Constitution binds

* Document No. 28, Reorganization Court Record.

the Reorganization Court as well and that means that private property cannot be taken for a public use (railroads are affected with a public interest and empowered to condemn for that reason) without payment of just compensation."

A decision of this Court in which the New York Central Railroad Company and the New York and Harlem Railroad Company were defendants as condemnors strongly supports this view, *Muhlker* v. *New York and Harlem Railroad Company, et al.*, 197 U. S. 544 (1905).

In that case these railroad companies had been directed by a New York statute to construct an elevated railroad structure over Park Avenue and to lift their tracks from the street and to put them on the elevated structure. The plaintiff was the owner of property abutting on the Park Avenue structure and he claimed that the railroad companies in complying with the statute became liable to him for condemning his property by way of impairing his easements of light and air. The condemning railroads argued that the plaintiff's easements were subject to the police power and the taking was required by the State in the public interest and that they were not liable for the taking. This Court held that the railroads were in fact condemning the plaintiff's easements pursuant to authority and direction of the State and were liable for the damages.

Here, as the Commission says, by reason of the requirements imposed by the Commission in order to block liquidation, Penn Central is taking the property of the New Haven to keep it operating because of the public interest. Consequently, since liquidation is prevented by such taking by Penn Central, Penn Central is liable for the property taken in the amount of the liquidation value of the property. If the New Haven and its bondholders do not receive at least liquidation value, it will constitute a violation of

the due process clause and a taking of private property for public use without just compensation—all contrary to the Fifth Amendment to the Constitution of the United States.

The principle was fully recognized by the three-Judge Court in its first decision (289 F. Supp. at pp. 440-1, App. 359a-361a). The Reorganization Court came to the same conclusion, but without even needing to reach the constitutional ground (289 F. Supp. at p. 454, App. 239a).

As stated above, the Commission has argued that the inclusion of the New Haven is a burden to Penn Central and not valuable to Penn Central, for one reason because Penn Central cannot realize the liquidation value (334 I.C.C. at p. 66, App. 153a). But it has been authoritatively held that, in the case of a taking either by a public authority such as a city, or by an instrumentality on behalf of a public authority in the public interest, the fact that the property taken has lesser value to the taker than it has to the owner, or even has no value to the taker, does not relieve the taker from paying to the owner the full value of the property taken* (*Matter of City of N. Y. (Fifth Avenue Coach Lines, Inc.)*, 22 N.Y.2d 613 (1968)).

There the New York Court of Appeals confirmed its prior decision in *Matter of Port Auth. Trans-Hudson Corp.* [*Hudson Rapid Tubes Corp.*], 20 N.Y.2d 457 (1967), *cert. denied* 390 U. S. 1002 (1968), by holding that the City which had taken the properties of the Fifth Avenue Coach Company must pay to it the value of its franchises although

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* As was stated in *St. Agnes Cemetery* v. *State of New York*, 3 N.Y.2d 37 (1957) at p. 41:

> "It is axiomatic that in appraising land the fundamental question to be answered is 'what has the owner lost, not what has the taker gained' (*Boston Chamber of Commerce* v. *Boston*, 217 U. S. 189, 195 [1910]) . . .".

What the New Haven has lost here by reason of the taking is the liquidation value of its property which it could have realized if not for the taking.

the franchises were of no value to the City because they were not needed by the City to operate the bus lines. That situation is analogous to the present case and the holding is applicable here.

Another aspect of the *Port Authority* case, *supra,* is also important here. In that case, the condemned railroad facility was found to be inherently incapable of operating at a profit and its liquidation value was also found to be nominal; but the Court of Appeals fixed the condemnation price at depreciated original cost which was many millions of dollars above the nominal liquidation value.*

We respectfully ask the Court to determine that, under the circumstances of the present case, the New Haven, at least by the valuation date of December 31, 1966, had the constitutional right to discontinue railroad operations and to commence liquidation and that it is entitled to be paid liquidation value as of that date by Penn Central for its assets which were sold to Penn Central.

We now proceed to a discussion of the two unjustified discounts which the Commission adopted in its effort to implement its predetermined view that the amount of its net liquidation value finding would be too high a price for the New Haven assets.

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* The Court of Appeals said (20 N.Y.2d at p. 468):

"We are here concerned with a property which has a usefulness created by the owner himself through the expenditure of large sums of money and by the continued operation of the property for the very purpose for which the petitioner is acquiring the property. It is the owner who built the 'reservoir'—the Tube railway system in the present case. This owner has developed its property at a cost of millions of dollars and operated it for more than 50 years. It is admittedly of great usefulness in the daily transportation of thousands of commuters. A condemnor should not be permitted to tell him: 'It's only worth scrap or less'."

POINT II

The two new discounts by means of which the Commission sought to arrive at a price substantially below liquidation value are specious and unwarranted as the Reorganization Court and the dissenting Judge of the three-Judge Court found.

(Questions 6, 7 and 8)

The Commission in its Fourth Supplemental Report sought to reduce the price to an amount substantially less than net liquidation value (specifically found by it to be $162,700,000) by deducting $22,000,000 for two discounts which it called "other pricing considerations" (334 I.C.C. at p. 53, App. 140a).

The instruction to the Commission in the July 10, 1968 three-Judge Court opinion (289 F. Supp. at p. 441, App. 361a) had been to submit an alternative legal standard (another "pricing theory") for submission to this Court if the Commission disagreed with the net liquidation value standard approved by the three-Judge Court (and concurred in by the Reorganization Court). For the Commission to proceed to deduct millions of dollars of additional expenses from its new finding of net liquidation value was not a submission by it of any alternative standard of value.*

* In this connection, the Reorganization Court said in its May 28, 1969 opinion (304 F. Supp. at p. 799, App. 281a):

> "The Commission's Fourth Supplemental Report and its counsel's express admission in oral argument before this court have made clear that the Commission neither developed nor applied a new or different pricing theory; but purported to base its determination on fair liquidation value. Its newly conceived deductions for delay in issuing an abandonment certificate and for a bulk sale discount are described by the Commission as 'refinements' of the fair liquidation value theory."

The June 18, 1969 Opinion of the three-Judge Court majority seeks to justify the Commission's injection after the remand of these two new discounts on the theory that a commission may on remand receive and consider any further evidence it chooses (App. 402a). In support of this view the Opinion cites *F.C.C.* v. *Pottsville Broadcasting Co.*, 309 U.S. 134, 145 (1940) and *Fly* v. *Heitmeyer*, 309 U.S. 146, 148 (1940). Both of those cases related to radio broadcasting and to situations where on appeal it had been found that the Federal Communications Commission had made a mistake of law with respect to denying a license to an applicant and where upon remand the Commission proceeded to consider new rival applications along with the original application. This Court held that such broadening of the issues was permissible in order that the Commission be free at all times to carry out the policy of the Communications Act.

These cases and the principle they stand for are not in point in the present situation. Here there was not a broad remand for general reconsideration of policy questions. There was a limited remand for the making of corrections of specific matters in the light of the stated legal rulings of the reviewing Courts. As appears clear and as is stated in *Jaffe—Judicial Control of Administrative Action* (1965), at p. 715, "a court should and does have the power to remand for a limited purpose."

To be concrete, when the reviewing Courts, in remanding the case, requested that the Commission make findings to support application of the Courts' liquidation value standard (and of any alternative valuation standard proposed by the Commission if the Commission did not agree with the Courts' liquidation value standard), that certainly did not contemplate that the Commission would be free to make important alterations in the liquidation value stan-

dard and its application as already determined by both Courts.

It is especially surprising for the majority of the three-Judge Court in their second round Opinion to be supporting the view that the Commission after remand could accept and consider any evidence it thought desirable and could inject new issues since (a) that Court's order of remand vacated only so much of the Commission's Second Supplemental Order as found the purchase agreement terms and the interim loss-sharing arrangements to be just and reasonable and remanded the cause to the Commission "for further proceedings consistent with this opinion" (289 F.Supp. at p. 448, App. 375a) and (b) that Court's accompanying Opinion stressed that the hearings after remand should be minimal, saying (289 F.Supp. at p. 448, App. 375a-376a): "To the extent that new testimony is required, this should be held to a minimum; we do not mean by this opinion that parties who had a full opportunity to present evidence must be given a new turn."

There is no doubt that the Commission's remand hearings were conducted on the basis that there had been a remand for limited purposes. The Examiner at the outset said so in so many words (Tr. 28678):

> "We are going to restrict these hearings and necessarily so, to the matters which were remanded to the Commission's attention by the three-judge and reorganization courts."

In any event, the Commission was not warranted on remand to make these two deductions from net liquidation value on pretexts which the Commission had never theretofore suggested and which were devised to carry out a preconceived notion that the liquidation value price would be "unfair" to Penn Central. The Reorganization Court

said in its May 28, 1969 opinion (304 F. Supp. at p. 804, App. 291a): "The Commission never entertained any such concept on the first round". And the dissenting Judge of the three-Judge Court said in his recent opinion (App. 433a), the Commission "gave with one hand and took away with the other".

In the Fourth Supplemental Report, the Commission is blunt in its acknowledgment that the two new discounts were mere devices to reduce the liquidation value price. The Commission makes it clear that it considered abstractly that liquidation value was too high a price (despite the prior unanimous ruling of both Courts to the contrary), and that it should be reduced to a lower price considered by it abstractly to be fair (thereby reinstating in considerable measure the original disapproved low liquidation value price). Thus, the Commission said in the Fourth Supplemental Report (334 I.C.C. at p. 57, App. 144a):

> "The alleged right to liquidation values derives from an alleged right to abandon; and there are recognized limitations on the right to abandon that in themselves limit the creditors' entitlement to the liquidation value we have computed *under the court's instructions.* Under section 1(18) of the Interstate Commerce Act, the Commission is empowered to impose reasonable limitations on the abandonment right. The pricing out of such limitations permits us to reach what we consider to be a fair price on the present record, and we need go no further." (Emphasis added).

(a) In the above-quoted statement, the Commission recognizes that its liquidation value finding of $162,700,000 is the value as computed by it "under the Court's instructions". (b) It then asserts that the Commission may re-

duce the liquidation value so computed, by imposing reasonable limitations on the abandonment right (from which it says the right to liquidation value is derived), although it does not here specify the nature of such permitted limitations.* (c) Then the Commission caps the climax by concluding that by "pricing out of such limitations" it can reduce the higher "unfair" price (liquidation value) to a lower "fair" price. Why deduction from an "unfair" price of the result of "pricing out" such limitations should happen to produce a "fair" price is nowhere explained. (d) There could hardly be a clearer manifestation that such "pricing out" was a sham since it had the ulterior motive of cutting the cloth to fit the Commission's preconceived view (developed after the remand by both Courts) that liquidation value, as computed under the Court's instructions, would have to be reduced to arrive at a price it considered to be fair to Penn Central.

It is to be noted that there actually was no "pricing out" by the Commission anywhere of any legal limitation on the right to abandon. Instead, the Commission merely sought to increase very substantially its original finding of the expenses of liquidation by stretching out the six-year liquidation period for an additional period as proposed by Penn Central and by introducing a so-called "bulk sale discount" also concocted by Penn Central. Where was there any "pricing out" of a power vested in the Commission to impose a limitation on an abandon-

* Such limitations apparently are supposed to consist of the alleged power of the Commission in the present case (i) to delay unnecessarily and arbitrarily for one year, at an alleged cost of $15,386,000, the issuance of an abandonment certificate to which the New Haven would obviously be entitled promptly, if it need be obtained at all, and (ii) to refuse to allow break-up of the New Haven system unless there was a bulk sale to an unnecessary middleman who would be brought in and paid an honorarium of $6,695,000.

ment? Was it the claimed power of the Commission to impose an arbitrary one-year extension in order to reduce the price by unnecessarily delaying the inevitable? Or was it the power to compel a bulk sale in order to reduce the price by providing compensation for an unnecessary middleman? In either case, there was no "pricing out" of any limitation which the Commission could impose; there was only an invalid rationalization adopted for the purpose of reducing the purchase price payable by Penn Central.

As the Reorganization Court said in its May 28, 1969 Opinion concerning the Fourth Supplemental Report (304 F.Supp. at pp. 804-5, App. 291a):

> "Its [the Commission's] declared reasons for not doing so [not giving the New Haven liquidation value] are transparent pretexts under the cover of which the Commission arbitrarily and capriciously confers a benefit—not on the public—but on Penn Central, which would obtain New Haven's assets at a price substantially below fair liquidation value and yet comply with the condition for the Pennsylvania-New York Central merger that it take over the New Haven."

The Reorganization Court in its discussion relating to Section 77 also said (304 F.Supp. at p. 798, App. 281a) that "in its Fourth Supplemental Report the Commission found the liquidation value to be $162.7 million, then ordered the sale of the debtor's property for $22.1 million less. This court concludes that the Commission's order in thus reducing the predetermined liquidation value, illegally contravened the statute".

We discuss in subpoints A and B below each of the two new unwarranted discounts.

A. *The device of "stretching out" the six-year liquidation period so as to discount the net liquidation value and price by $15,386,000 had no justification.*

By far the larger of the Commission's two new discounts purports to be based on a "stretch out" of the six-year period of liquidation which had been used in both the Second Supplemental Report and the Fourth Supplemental Report in arriving at net liquidation value. This one-year "stretch out" was estimated by the Commission to require a reduction of $15,386,000* from net liquidation value in order to arrive at a purchase price. Such deduction (herein sometimes referred to as the "delay" discount) was in addition to the enormous expenses which had already been deducted in arriving at a net liquidation value figure on the basis of an assumed six-year period of liquidation, commencing December 31, 1966. The delay discount was based on the supposition that, in addition to the six-year period of liquidation, there would be a further delay of one year to obtain a certificate from the Commission permitting cessation of New Haven's operations.

The three-Judge Court in its first decision expressly overruled the Penn Central contention of additional delay for an abandonment proceeding by saying unanimously (289 F. Supp. at pp. 438-9, App. 354a-355a):

> "A much more significant item is raised by the claim that before the NH Trustees could even begin a liquidation, lengthy abandonment proceedings would be re-

* The bondholders having contended that this $15,386,000 was a highly inflated figure, the three-Judge majority said (App. 415a) that their "arguments are not without persuasiveness" but that they were offset by the Commission's failure to make other decisions which would have been adverse to the bondholders. Under the *Chenery* doctrine (*Securities Commission* v. *Chenery Corp.*, 318 U.S. 80 (1943); 332 U.S. 194 (1947)), it was not for the Court to decide that substantial Commission errors were offset by adverse action which the Commission might have taken but did not.

quired, during which large cash losses would be incurred and the property would further depreciate. The bondholders respond that if inclusion of NH in Penn Central had not been in prospect, the NH Trustees would have been under a duty to initiate abandonment proceedings as soon as they reported, on December 31, 1963, that there was no prospect for independent operations of NH, and that December 31, 1966 is thus an entirely reasonable date for the beginning of the assumed liquidation. Indeed, they insist they are entitled to be fully protected against losses thereafter—a contention we shall discuss below. Our rejection of that contention, see section VII of this opinion, means that a considerable portion of the losses will be borne by the NH estate, and there would be no justification for a double deduction. Beyond that, the Commission had to pick a date for valuation and December 31, 1966 was a reasonable choice. If we were to posit a liquidation beginning only some years hence, we could not simply deduct interim cash losses and depreciation but would have to ask the Commission to revalue the assets and this might yield a higher price. 698." [The reference to "698" is to 331 I.C.C. at p. 698, App. 56a.]

And again, after referring to "the constitutional right of NH to cease operation and liquidate" because of its large operating losses, the three-Judge Court in its first opinion went on to say unanimously (289 F. Supp. at pp. 440-1, App. 359a-360a):

"We see no reason to question the validity of Justice Holmes' decision in Brooks-Scanlon Co. v. Railroad Commission, 251 U. S. 396, 40 S.Ct. 183, 64 L.Ed. 323, forbidding the State of Louisiana to require a

railroad to continue its deficit operation with no hope for profits in the foreseeable future. See also, Mora v. Mejias, 223 F.2d 814 (1 Cir. 1955); Railroad Commission v. Eastern Texas R. R., 264 U. S. 79, 85, 44 S.Ct. 247, 68 L.Ed. 569 (1924); Bullock v. State of Florida ex rel. Railroad Commission, 254 U. S. 513, 41 S.Ct. 193, 65 L.Ed. 380 (1921); cf. Pacific Telephone & Teleg. Co. v. Tax Comm'n, 297 U. S. 403, 413, 56 S.Ct. 522, 80 L.Ed. 760 (1936). We cannot accept the argument that all this was changed by the addition of §1(18), requiring the Commission's consent to abandonment, to the Interstate Commerce Act by the Transportation Act, 1920, or by the enactment of §77 of the Bankruptcy Act in 1933. These statutes were designed to assure orderly procedures and to afford methods that might avoid the ultimate solution; they were not intended to override constitutional guarantees, cf. In re Third Avenue Transit Corp., 198 F.2d 703, 707 (2 Cir. 1952), and would not be effective if they had been." [Footnote omitted]

Less than one year later two Judges of the three-Judge Court unaccountably reversed themselves and accepted Penn Central's suggestion of a large delay discount from the liquidation value price for an alleged further delay of one year* in addition to the six-year period of liquida-

* This one year of delay which would allegedly cost the New Haven $15,386,000 is assumed to occur notwithstanding that the Commission is supposed to be "acting with appropriate speed" (App. 408a) in a situation where the essential facts are indisputable.

As mentioned earlier, the Reorganization Court stated in its May 28, 1969 Opinion that, if abandonment proceedings were necessary, such proceedings should be *pro forma* and take only four to six weeks, since the "New Haven had been studied, examined and reported on almost continuously since 1957" (304 F. Supp. at p. 797, App. 305a). The Reorganization Court further

tion, the expenses of which were already fully reflected in the liquidation value price.

In its May 28, 1969 Opinion, the Reorganization Court said concerning the delay discount (304 F. Supp. at p. 801, App. 285a-286a):

> "It is also inequitable to penalize the New Haven an additional $15,386,000 as the consequence of delaying abandonment in a hypothetical liquidation proceeding, so that the political units and representatives of the public interest could be heard, when, but for the adoption by the Trustees of a course to serve the public interest, abandonment proceedings could and would have been commenced in late 1963 and liquidation would have been started, certainly by the valuation date of December 31, 1966. . . .
>
> "This court adheres to the position that due process and just compensation provisions of the Fifth Amendment prohibit the imposition of a further period of erosion of assets on the New Haven. It has ruled that any erosion additional to that accumulated through 1968 would be constitutionally impermissible as a taking without just compensation. But in its Fourth Supplemental Report the Commission asserts that the constitutional limitation sets up no standard of value and is very flexible, so that it leaves the Commission with an almost completely unrestricted discretion so long as it declares that its decision is fair and equitable

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pointed out that in the *Tennessee Central Railway Company* case, 333 I.C.C. 443 (1968), the abandonment proceedings took only two-and-a-half months. Likewise, in the *New York, Ontario & Western Railway Company* case, the interval between the application for abandonment and the obtaining of the abandonment certificate was less than three months. This appears from the opinion in *Kilsheimer* v. *Rose & Moskowitz*, 257 F. 2d 242 (2d Cir. 1958).

and in the public interest. The Three Judge Court and this court rejected that legal principle in their former opinions, 289 F. Supp. 418 at 440-441 and 289 F. Supp. 451 at 459; and the law as established by these courts was the law of the case which the Commission should have followed."

The Reorganization Court said as to the issue raised by the Commission "of the right to abandon as a condition precedent to liquidation" that it had been "hauled in by the heels" (304 F. Supp. at p. 805, App. 292a).*

Similarly, the dissenting Judge in the three-Judge Court was vigorous in his rejection of this delay discount (Opinion of June 18, 1969, App. 435a-438a) and concluded that the deduction "is without justification and is not based upon substantial evidence." He pointed out that the Commission's brief on the second round (p. 5) made clear its understanding that the remand did not contemplate a delay for an abandonment proceeding at heavy cost, since that brief stated that the Fourth Supplemental Report "makes detailed findings regarding the piecemeal liquidation value

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* The Reorganization Court said also (304 F. Supp. at p. 799, App. 281a-282a) that the Commission's view as to use of the pricing theory based upon fair liquidation value apparently "wholly derives from, and is completely subject to, the issuance of an abandonment certificate by the Commission, which it will not issue to a debtor, as a matter of right, though the debtor has for many years been submerged in a deficit operation with no prospect of improvement;[5] but may grant as a privilege in its sole discretion, to be given or withheld on the conclusory basis that its action is 'fair and equitable' or 'required by the public interest', and apparently unsupported by anything more substantial than the Commission's own introspections or the latest word from the Cumean Sybil."

"[5] Inclusion Report of I.C.C., dated November 16, 1967, 331 I.C.C. at 687: "If there is one thing on this record that is clear and undeniable, it is that NH has neither earning power nor the prospect of earning power."

of the NH assets, as if an abandonment certificate were in hand on December 31, 1966, in accordance with the directive of the Three-Judge Court" (App. 437a). (The majority of the three-Judge Court thereupon stated that its "directive" had not been intended to be binding upon the Commission (App. 414a).)

B. *The device of decreasing the net liquidation value and price by deduction of a $6,695,000 so-called "bulk sale discount" had no justification.*

The second device by which the Commission in the Fourth Supplemental Report sought to reduce net liquidation value and the price to be paid by Penn Central was to deduct a so-called "bulk sale discount" in the amount of $6,695,000.

The Commission endeavored to justify this newly conceived discount by a discussion under the heading "Limitation on the right to break up the railroad" (334 I.C.C. at pp. 60-3, App. 147a-150a). Accordingly, the primary basis stated for such discount (334 I.C.C. at p. 60, App. 147a) was the Commission's claimed right to compel a bulk sale of the assets of the New Haven to a purchaser who would continue the needed rail operations.

The Commission then purported, in line with its original thesis hereinbefore referred to, to "price out" this alleged limitation on the right of New Haven to proceed with liquidation and sale of its properties. In this instance, the "pricing out" was not only without foundation in law but the method employed was so ludicrous that it clearly demonstrated that the Commission was not proceeding from facts to arrive at a conclusion but was trying to support a predetermined conclusion which had no rational basis.

What the Commission did was not only (a) to assert erroneously that it could compel a bulk sale *at a discount* for

continued railroad operation but also (b) to measure such discount by the testimony of a land wholesaler (Mr. Simon) as to the discount he would require in order to purchase the New Haven assets in bulk *not* for continued rail operation but in order to sell them at retail.

The incorrectness of the Commission's conception that it could compel a bulk sale for railroad purposes at a discount has already been shown in Point I (B) above. But far more absurd is the other facet, namely, the Commission's adoption of the testimony of a land wholesaler (which related to a possible purchase at wholesale in order to resell at retail) as the basis for the Commission's calculation of the amount of discount from fair market value supposed to be required in order that an entirely different type of purchaser be induced to buy in bulk for continued railroad operation.

The two-Judge majority itself pointed out both fallacies involved, saying (App. 417a):

> "In the course of justifying the deduction, the Commission said 334 I.C.C. at 60, that 'the liquidation value urged by the creditors assumes not only the immediate right to abandon . . . but also the right to break up the railroad and sell the parcels for their highest and best price' and that the latter right 'may be restricted when a buyer for the entire bulk of the NH properties appears who will continue the operation of needed services.' We entertain the gravest doubt concerning the legal premise underlying this argument; we would suppose that the constitutional right to abandon operations implies a right to break up the railroad and sell the parcels for their highest and best prices. Moreover we fail to see the relationship of this argument to Mr. Simon's testimony, which was not at all concerned with a buyer 'who will continue the operation of needed

service' but rather with one who would do precisely what the NH estate proposed to do."

Moreover, the Simon testimony as to a bulk sale discount was merely calling for a duplication of some of the expenses and discounts already charged against the New Haven bondholders as part of the liquidation program. The net liquidation value of $162,700,000 was after deduction of *all* the expenses, large and small, of a liquidation program through sales at retail over a six-year liquidation period, including in addition a $17,000,000 discount to present worth of the estimated liquidation proceeds and an $8,000,000 slash of the appraised market value of New Haven land to allow for sales of land which it might be difficult to sell for their appraised market value (331 I.C.C. at pp. 661-2, App. 19a-20a). The sale program expenses included the cost of maintenance of a New Haven staff to conduct the sales of its properties over a six-year period—there having been deducted $15,900,000 of real estate department expense and $15,600,000 expense for sales of other property (331 I.C.C. at pp. 661-62, App. 19a-20a).

The two-Judge majority said (App. 417a) that Mr. Simon's testimony concerned a possible buyer "who would do precisely what the NH estate proposed to do". The conclusion to be drawn from the quoted words is clear. Since the deducted expenses included all the costs of the New Haven "per parcel" sale program, there could be no possible warrant for deducting the additional cost of Mr. Simon's buyer who only was to do "precisely what the NH estate proposed to do".

The Commission introduced another unsound permutation (334 I.C.C. at p. 61, App. 148a) by denying that in liquidation the New Haven would have the right "to sell off NH

in parcels" so that a wholesaler purchaser should be introduced to perform that operation. When such a wholesaler purchaser does not propose to continue railroad operation, it is incomprehensible (i) why the Commission should deny that the New Haven has the right to sell in parcels while it proposes that a wholesaler purchaser do it instead and (ii) why the Commission should insist on deducting the wholesaler's discount without offsetting against it already deducted expenses of the retail sale program of the New Haven.

The Commission (334 I.C.C. at p. 61, App. 148a) refers specifically to the bondholders' position that "they have a fixed right to sell off NH in parcels" and purports to answer it as follows:

> "Our answer is that we may compel the bulk sale and the bulk sale discount as a condition of an abandonment certificate, and, therefore, as a reduction of the present price."

We see not the slightest merit in the position of the Commission that, for the purpose of effecting a reduction in the price payable by Penn Central, it may compel a bulk sale by the New Haven at a discount to a purchaser for non-railroad use as a condition of issuing an abandonment certificate to the New Haven.

The majority of the three-Judge Court, having rejected the ratiocination by which the Commission sought to support the bulk sale discount, cast around for another way to sustain it. For this purpose, it refers (App. 417a) to the fact that the Commission had incidentally stated, before it computed the amount of its bulk sale discount, that "The bulk-sale discount merely reflects a market appraisal of the

risks that the estate avoids, and the bulk buyer assumes".* The majority opinion goes on to say (App. 417a) that, while this language of the Commission is not "pellucid", "we read this as saying that the Commission deducted the discount as a proper measure of risks not taken into account by the appraisals and the discount to present value".**

We submit that the Commission's language taken in context may not be so read. The Commission did not purport to measure its bulk sale discount by the degree of any alleged risk. Its measurement was based on the testimony of Mr. Simon who could scarcely have known what risks were covered and what were not covered by the appraisals since he had not seen them nor read the appraisers' testimony (Tr. 29858-60, 29879). He did not know how much acreage was involved in this proceeding nor what percentage of it was in Massachusetts or Connecticut (Tr. 29865).

He said he assumed that the appraisals were made by "reliable real estate appraisers" who had appraised the "fair market value" of the land (Tr. 29883-4). But reliable appraisers of the fair market value of land must be deemed to have taken into account the possibilities of both favorable and unfavorable developments in their appraisals. To discount sound appraisals on the theory that the appraisers must be deemed to have given proper weight to possible

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* The majority opinion refers in this connection (App. 417a) to the Commission's also having said that this discount "fully recognizes, without conceding, NH's right to abandon and liquidate the estate". What can this mean? How can a discount "fully" recognize something and not concede it? Is the Commission saying that this discount is wrong or that it is right or that it is neither? With all due respect, we must say that the quoted words seem to us meaningless.

** The Commission itself said in its Second Supplemental Report that its valuation of the New Haven assets was "sufficiently conservative" to offset some unfavorable factors (331 I.C.C. at p. 664, App. 22a).

favorable developments but to have given insufficient weight to possible unfavorable developments is but another means of duplicating the charges made against the bondholders.

The Commission also said (334 I.C.C. at p. 61, App. 148a) that "the bondholders' position that they are entitled to a per-parcel valuation is in effect an argument that they should be free to speculate with the assets of the estate". Here the Commission seems to be taking the extraordinary position that the complete liquidation program it had theretofore approved without reflection of any bulk sale discount involved a speculation with the assets of the estate. Is a shop-keeper who is retiring from business a "speculator" if he chooses to liquidate his business assets himself instead of selling them in bulk to a middleman at a cut-rate price? The Commission surely must have run out of reasonable arguments when it is driven to making this preposterous charge.*

In any event, there is no reason why the estate should be charged with an expense of $6,695,000 on account of the alleged risk. The risk referred to must relate to the level of real estate values since the bulk sale discount was applied only to land which constitutes the bulk of the New Haven assets (331 I.C.C. at p. 698, App. 56a). But, as the Commission pointed out in the Second Supplemental Report, there is at least as much likelihood that land values will increase as that they will diminish (331 I.C.C. at p. 698, App. 56a),* which would leave little basis for charging against the New Haven a large bulk discount for the purpose of reducing the price to be paid by Penn Central.**

* Mr. Simon naturally had to admit that, while there may be a risk of unforeseen unfavorable developments, there may also be unforeseen developments which will aid marketing plans and enhance values (Tr. 29846-7).

** The majority of the three-Judge Court sought to support the bulk sale discount by analogizing it to a premium for underwrit-

The dissenting Judge of the three-Judge Court described the bulk sale discount as "an unwarranted duplication of part of the expense already charged to the New Haven" (App. 439a). He continued:

> "Although my esteemed colleagues are compelled to 'entertain the gravest doubt concerning the legal premise' upon which the Commission postulated its theory, they purport to find justification for its acceptance by culling other statements from the Commission's report and deducing therefrom what the Commission really intended, to wit, a 'discount as a proper measure of risks not taken into account by the appraisals and the discount to present value.' Passing for the moment that this is not at all the theory relied upon by the Commission, which at once raises a question as to whether the agency action can be upheld,[22] the theory, when tested on the basis of what the Commission did, as opposed to what it might have done, is clearly erroneous and cannot prevail. The Commission's determination rests upon its assumed power to compel the bulk transfer to assure 'the continued operation of the property and preservation of its unity.'[23] However, the evidence upon which it justified the bulk sale deduction contemplated the sale of the real estate to a private developer who was in no way committed to the 'continued operation of the property and preservation of its unity.'[24]"

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ing an issue of securities (June 18, 1969 Opinion, App. 418a). There is no similarity. In the case of an issue of securities, there is a compulsion on the issuer to make a successful sale in a short period measured in days. In the New Haven situation there is no such compulsion; indeed, a six-year period of liquidation was fully provided for.

"[22] SEC v. Chenery Corp., 318 U.S. 80, 94 (1943).

[23] 334 I.C.C. at 61.

[24] R-29; T. 29799 et seq."

The May 28, 1969 Opinion of the Reorganization Court (304 F. Supp. at p. 806, App. 293a) charged the Commission with giving Penn Central a "gift of a double deduction" through this bulk sale discount. The Reorganization Court also said that the bulk sale discount deduction would be in violation of the debtor's duty to obtain no less than "what the market would pay, which is implicit in the standard used here, i.e. fair liquidation value"; and that the Court would not approve a sale for less.

The action of the majority in upholding the bulk sale discount clearly runs afoul of the *Chenery* doctrine (*Securities Commission* v. *Chenery Corp.*, 318 U. S. 80 (1943); 332 U. S. 194 (1947)), *supra*, which is to the effect that an agency decision involving exercise of discretion or judgment can be sustained by a reviewing court only on the grounds on which the agency itself acted. It is unquestionable that the majority of the three-Judge Court in the present case dismissed as unsound the grounds on which the Commission purported to act, namely, that it could require a bulk sale to a non-railroad wholesaler, and a bulk sale discount, as a condition of issuing an abandonment certificate. For the Court then to proceed to uphold the bulk sale discount on a vague substitute theory regarding its being compensation for assumption of a risk (an idea barely mentioned by the Commission (334 I.C.C. at p. 61, App. 148a)) is to sustain the discount on grounds on which the Commission did not act, in violation of the *Chenery* doctrine.

We respectfully ask the Court to determine that the delay discount and the bulk sale discount should not have been deducted from net liquidation value or from the price payable by Penn Central.

POINT III

It was erroneous for the Commission to require no payment by Penn Central for the transfer to it free and clear of any restrictions of that portion ($5,600,000 annually) of New Haven's net income from the Grand Central non-railroad properties which was formerly used to defray New Haven's user share of the expenses of the railroad Terminal.

(Question 9)

Among the assets of the New Haven taken over by Penn Central pursuant to the Commission's Fourth Supplemental Order (App. 219a) was the New Haven's interest (approximately 50%) in extremely valuable hotel and office building properties in the Grand Central area (appraised some time ago as a whole at $227,000,000*). However, the Commission awarded the New Haven no consideration whatsoever for the major portion of this asset. The portion which was taken over by Penn Central without any consideration was the New Haven's share ($5,600,000 per annum) in the net income of these properties which was formerly used to pay the New Haven's user share of Terminal expenses but which at the end of 1968 was conveyed to Penn Central free and clear of any restriction whatsoever as to use. (The Commission and the Courts did require Penn Central to credit the New Haven with $28,400,000 of consideration for the New Haven's share (50%) of the value of the estimated *excess* income of the

* Ex. NHI-1 (Appendix A); Ex. NHI-19. (Both exhibits are included in Document No. 118 of the three-Judge Court Record.) The Second Supplemental Report states that $115,000,000 is "50 percent of the value of the Grand Central nonoperating properties as developed in an independent appraisal made on behalf of the NH trustees" (331 I.C.C. at p. 680, App. 38a).

Grand Central non-railroad properties which had not been used to pay expenses of the Terminal (334 I.C.C. at p. 39, App. 126a).)

The three-Judge Court refused to disturb the action of the Commission in awarding no consideration for such $5,600,000 of annual income which has been transferred to Penn Central, but the Reorganization Court in its first Opinion stated that, in succeeding to that income, "a valuable interest will have been acquired" by Penn Central (289 F. Supp. at p. 463, App. 253a) and left it to the Commission on the remand to find the value.

In the second round, the Reorganization Court initially acquiesced (304 F. Supp. at p. 806, App. 294a) in the rejection of the bondholders' claim for additional compensation for the New Haven Grand Central rights. However, the Reorganization Court in a later opinion pointed to the controversy over this asset as support for that Court's conclusion that appeals from both Courts were inevitable, the Court stating that, if the New Haven's right to this asset were to be recognized, the record would show a potential worth for this asset of approximately $70,000,000 (Opinion of July 28, 1969, 304 F. Supp. at p. 1124, App. 314a-315a).

The principal reason advanced as to why the New Haven should not receive consideration for this asset is that under the old agreement* between the New Haven and the New York Central existing prior to New Haven's inclusion, this portion of the New Haven's share of the net income of the non-operating properties in the Grand Central area was applied on a user basis to pay expenses of the Terminal, as was the corresponding share of net income belonging to

* Section 14 of the 1910 basic agreement (Ex. NHI-87, p. A-15; this Exhibit is included in Document No. 120 of the three-Judge Court Record.)

New York Central. But this agreement was wiped out by its transfer on December 31, 1968 by the New Haven to the other party to the agreement (Penn Central, as successor by merger to Central). The agreement thereafter was no longer in existence, and Penn Central now has this income (both the former New York Central's share and the former New Haven's share) free and clear of any restriction against its use in any way Penn Central sees fit. In other words, Central's (now Penn Central's) share as well as the New Haven's former share in such income is by reason of the transfer no longer subject to any restriction of any kind in the hands of Penn Central. Nevertheless, the New Haven has received nothing for such transfer of its $5,600,000 per annum to Penn Central free of restriction.

There is no basis for treating the New Haven's $5,600,000 per annum of net income as being without value on the closing date. Other adjustments had to be made in liquidation value to arrive at the purchase price on the closing date and an adjustment should also have been made for the New Haven's valuable interest in this net income. The other adjustments to liquidation value to which we refer are those for New Haven assets not sold to Penn Central and those for accrued real estate taxes which the New Haven remained bound to pay.

(1) Since under the Purchase Agreement as approved, a substantial amount of New Haven assets was retained by the New Haven Trustees, the New Haven's liquidation value had to be adjusted downward in order to exclude the value of the retained assets (331 I.C.C. at p. 661, App. 19a). (2) Since the property was conveyed to Penn Central free and clear of accrued tax liens, the amount of such taxes which had been deducted to arrive at liquidation value had to be restored to the value and the purchase price in order to reflect the contract situation (334 I.C.C. at p. 40,

App. 127a). (3) Since the New Haven's share of income of the Grand Central non-railroad properties theretofore used to defray Terminal expenses was conveyed to Penn Central free and clear of the restrictive Terminal agreement which had provided for payment of Terminal expenses and was usable by Penn Central for any purpose on and after the closing date, the 100% discount from the value of this stream of income on account of such former restriction must be restored to the value and the price.

The three-Judge Court bypassed the New Haven's clear right upon the closing date to payment for all of its interest in the net income of the Grand Central non-railroad properties. It did so by indulging in an irrelevant discussion of the alleged ability of the State of New York to take over operation of the railroad line into the Terminal and obtain free access to the Terminal (June 18, 1969 Opinion, App. 419a-420a). Such free access for the State is said to be predicated upon the New Haven's interest in the net income of the hotel and office buildings vanishing in event of the liquidation of the New Haven and therefore being unsalable by the New Haven to the State. But that argument begs the question.

We have not contended that the New Haven would have to be compensated by the State of New York, as the contemplated successor in the Terminal railroad operation, for New York's obtaining the right to take over the former New Haven railroad operation into the Terminal. What is involved is the right of the New Haven to obtain compensation from Penn Central, as transferee, for all of the New Haven's partnership interest in the Grand Central hotels and office buildings which were jointly constructed and financed by the New Haven and New York Central. In a final decision of the New York Courts in the litigation between the New Haven and New York Central involving

one of the Grand Central hotels, it was held that the New Haven and New York Central each had a vested partnership interest in the Grand Central hotels and office buildings (*New York Cent. R. R. Co.* v. *New York, New Haven & Hartford R. R. Co.*, 24 Misc. 2d 414 (Sup. Ct. N.Y. County, 1960), *modified* (in a respect not relevant here), 13 A.D.2d 309 (1st Dept., 1961), *aff'd without opinion*, 11 N.Y.2d 1077 (1962)).

To that partnership property belonging to the New Haven, the State of New York would have no possible claim if it should succeed to the railroad operation—it could not confiscate the New Haven's interest in those non-railroad properties, or even condemn such non-railroad properties upon payment of just compensation. Following New Haven's inclusion, the State could acquire that interest only by purchase from Penn Central.

A. *The provision of the basic lease agreement purporting to prohibit its assignment does not apply to an assignment by operation of law.*

Penn Central has argued that the provision in the Grand Central Terminal 1910 basic lease agreement purporting to prohibit its assignment militated to some extent against the New Haven's realizing upon its partnership interest in the Grand Central hotels and office buildings following its discontinuance of transportation operations. The majority of the three-Judge Court gave little attention to that contention, but mentioned, in passing, the possibility that the anti-assignment clause might be an obstacle to a transfer (App. 419a). The Reorganization Court simply expressed the view (304 F.Supp. at p. 806, App. 294a), erroneously we submit, that the New Haven interest could not be assigned.

Breach of the non-assignment clause could hardly result in a forfeiture of the New Haven's partnership interest in the non-railroad hotels and office buildings. Even apart from that, the law clearly is that the language of the anti-assignment clause here involved is not sufficient to bar an assignment by operation of law (such as a transfer in bankruptcy or a transfer incident to a merger). A transfer of the New Haven's Grand Central lease and partnership interest by operation of law could easily be part of the procedure for the liquidation of the insolvent New Haven.

The 1910 basic agreement provided in paragraph 6 (Ex. NHI-87, pp. A-11-12)* that the New Haven agreed "not to assign this lease". However, the provision contained no express prohibition against an assignment *by operation of law*. It was the law prior to the 1910 lease, and it has been the law since, that an assignment by operation of law is not embraced within an assignment prohibition which does not expressly refer to an assignment by operation of law. That rule was incorporated into the Bankruptcy Act as part of the 1938 amendments, as will be set forth later herein.

Gazlay v. *Williams*, 210 U.S. 41 (1908), is a leading case on this subject. There the lease had provided that an assignment by the lessee without consent of the lessor would entitle the lessor to terminate the lease. The lessee became bankrupt and the lessor sought to terminate the lease. It was held that the transfer to the bankruptcy trustee was by operation of law and that such transfer, and the subsequent sale by the trustee of the lessee's interest, were not prohibited since there was no express prohibition against such a transfer in the lease.

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* This Exhibit is included in Document No. 120 of the three-Judge Court Record.

A later such case is *In re Prudential Lithograph Co.*, 270 Fed. 469 (2d Cir. 1920) *cert. denied*, 256 U.S. 692 (1921), where the Court said (p. 473):

> "A covenant against an assignment of a lease can be so drawn as to provide for a forfeiture by an assignment by operation of law, but there is no such express provision in the lease before the court, and in its absence a court will not infer one."

This rule became part of the Bankruptcy Act in 1938. Section 70(b) of the Bankruptcy Act provides:

> "A general covenant or condition in a lease that it shall not be assigned shall not be construed to prevent the trustee from assuming the same at his election and subsequently assigning the same; but an express covenant that an assignment by operation of law or the bankruptcy of a specified party thereto or of either party shall terminate the lease or give the other party an election to terminate the same is enforceable."

The law in New York is the same. In *Francis* v. *Ferguson*, 246 N.Y. 516 (1927), it was contended that the lessee's executor was barred from disposing of the lessee's interest in a lease because it contained a simple provision against assignment. This contention was overruled, the Court saying (p. 518):

> "An ordinary covenant against assignment does not bind the executors of the tenant and is not broken by a transfer of the leased premises by operation of law. (*Squire* v. *Learned*, 196 Mass. 134; *Gazlay* v. *Williams*, 210 U.S. 41.) The covenant may, however, be so drawn as expressly to prohibit such a transfer. To accomplish such a prohibition in case of a devolution to executors, its language must be 'very special.' (*Seers* v. *Hind*,

1 Ves. Jr. 294.) Such covenants are construed 'with the utmost jealousy.' (*Riggs* v. *Pursell*, 66 N.Y. 193, 201.) The use of general language, not specially related to the covenant against assignment—language which the law would imply as a term of the lease—is not the 'very special' prohibition which the cases require."

A case applying the same principle where a lessee was merged with another corporation which thereby succeeded to the lessee's interest by operation of law is *Dodier Realty and Inv. Co.* v. *St. Louis Nat. Baseball Club*, 238 S.W.2d 321 (Sup. Ct. Missouri 1951).*

Williston on Contracts, Third Ed. §422 states the rule as follows: "A general prohibition against assignment is interpreted to mean assignment by voluntary act and not to include assignment by operation of law".

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* There is a decision of the Court of Common Pleas of Luzerne, Pa. (*Feely* v. *Harwood Electric Company*, 22 Luzerne Legal Register Reports 314 (1920)) which might be argued to set forth a minority view that, in this connection, a transfer incident to a merger was not different from an assignment directly by the lessee. Not only would this view be contrary to the great weight of authority as set forth above, but the ruling may in large part be attributed to the broad language of that lease prohibition, namely (p. 315):

"Said lessee will not assign this lease nor underlet the premises hereby demised nor any part thereof nor use the said premises in any other manner nor any other purpose than office and store rooms, without consent in writing of the said lessor; assignment within the meaning of this lease being understood and intended to comprehend not only the voluntary action of the lessee but also every levy or execution or other legal process and every act of bankruptcy or every assignment or sale in bankruptcy, insolvency, or under any other compulsory procedure or order of court;".

As to that clause, the Court said (p. 318) that ". . . here is a perfectly plain, explicit, and unequivocal covenant standing in no need of assistance for its proper interpretation . . .".

B. *There has been no "dedication" of any portion of the New Haven's partnership interest in the net income of the Grand Central hotels and office buildings to the payment of Grand Central Terminal expenses.*

Penn Central has also argued that the New Haven partnership share in the non-operating net income is irrevocably "dedicated" to payment of Terminal expenses. It is not apparent on what legal theory this so-called "dedication" might be claimed to survive the cancellation of the agreement which is said to contain such obligation. The argument seems to be that the claimed survival resulted from creation in or after 1910 of a trust relationship which somehow subjected this stream of New Haven income forever to payment of Terminal expenses. There is no substance to any such trust theory.

No trust theory is needed to explain why, while the basic agreement existed and the New Haven used the Terminal, it was obligated under contract principles to pay its share of the Terminal expenses as provided in the agreement. It is equally clear that no trust theory can support the Penn Central concept that, upon termination of the basic agreement simultaneously with New Haven's inclusion on December 31, 1968, the New Haven's $5,600,000 annual stream of income from the non-operating properties remains perpetually and irrevocably "dedicated" to the payment of a portion of Terminal expenses.

It is hornbook law that in order to create a trust "there must be either an explicit declaration of trust, or circumstances which show beyond reasonable doubt that a trust was intended to be created." (*Title Guarantee & Trust Co.* v. *Haven*, 214 N. Y. 468, 481 (1915)). No such explicit declaration exists here nor any indication of such an intention, let alone an intention shown "beyond reasonable doubt."

The basic agreement contained nothing which intimates that the New Haven's partnership interest in the non-railroad properties was to be subject to a trust to pay Terminal expenses which would survive the termination of the agreement. Who are the trustee and the beneficiary of that trust? Certainly they cannot both be Penn Central as a trustee for itself. Or would this "trust" have no trustee or beneficiary but be operated by a disembodied spirit which, after termination of the basic agreement, would somehow without human intervention funnel net income from the non-operating properties directly to payment of Terminal expenses for the benefit of "whom it may concern"?

The New Haven has been deprived by the Commission and the Courts below of up to $70,000,000 in capitalized value because of the failure to require Penn Central to pay compensation to the New Haven for the $5,600,000 annual stream of income described above.

We respectfully ask the Court to determine (contrary to the decrees of both Courts below) that the New Haven is entitled to substantial compensation from Penn Central as consideration for the transfer to Penn Central of the New Haven's valuable partnership interest amounting to $5,600,000 of annual net income which is derived from the Grand Central hotels and office buildings and which was formerly used to defray New Haven's share of Grand Central Terminal expenses on a user basis.

POINT IV

The Commission's limitation on Penn Central's reimbursement to the New Haven for its losses in the period after the merger of Penn and Central was erroneous.

(Questions 10 and 11)

The Commission in the Second Supplemental Report (331 I.C.C. at pp. 714-20, App. 72a-78a) approved a formula for the "sharing" of New Haven losses by Penn Central from the date of the Penn Central merger to the date of New Haven's inclusion. The formula is inadequate in two substantial respects. First, the Commission placed an arbitrary limit of $5,500,000 a year (prorated to $5,000,000 for 11 months) on the amount of Penn Central's "share" of the New Haven's loss; and second, it arbitrarily omitted from the formula substantial items of loss which should have been included. For the 11 months, the formula loss was about $7,500,000 and the total loss, including items arbitrarily omitted, was in excess of $10,000,000.

A. *The Commission's limitation to $5,000,000 of the amount of New Haven's formula losses to be borne by Penn Central was arbitrary and unjustified.*

At the time the limit of $5,500,000 a year was fixed by the Commission (Second Supplemental Report, 331 I.C.C. at pp. 718-9, App. 76a-77a), it was somewhat in excess of the amount, $5,400,000, which the Commission estimated would be the formula loss of the New Haven for the first year following the Penn Central merger.* The Commis-

* In endeavoring to explain why "we think it unfair to leave open the upper limit of Penn-Central's share of the NH operating loss" the Commission says in the Second Supplemental Report (331 I.C.C. at pp. 718-9, App. 76a-77a) that "While the NH trustees could not predict the amount of the NH's operating loss in 1968 and future years, they indicated that they did not expect future

sion based that finding on the New Haven's figures for 1967 (331 I.C.C. at pp. 717-8, App. 75a-76a), which were the latest figures then available. Accordingly, the limit was not originally fixed with any idea of having it result in a "sharing" of the formula loss in the initial year between New Haven and Penn Central, but the Commission intended to have Penn Central take up the entire formula loss for the initial year following the Penn Central merger.*

The subsequent discussion by the Commission and the Courts relating to Penn Central not taking up all the formula losses of the New Haven for the period involved was caused by the accident that the formula loss figure for the first year prior to inclusion increased, by the time the Courts dealt with the matter and the Commission dealt with the matter on remand, from the original $5,400,000 per annum based on 1967 figures to $8,200,000 per annum

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cash attrition to be as large as in 1967. In view of this, it is not likely that the formula would produce a figure as high as $5.4 million in succeeding years. Accordingly, we shall set a limit of $5.5 million as the maximum Penn-Central share in any year."

Thus the reason stated for imposing a maximum limit is that it is not expected to come into operation in 1967 or future years. That we submit is an unsound basis for fixing a limit.

* That the Commission intended to impose on Penn Central all of the expected formula loss for the initial year is supported by the following statement in the Second Supplemental Report (331 I.C.C. at p. 715, App. 73a):

> "Penn and Central claim that imposition of the NH's operating losses on Penn-Central prior to the purchase of the NH's property would violate the standards of section 5(2)(b) of the Interstate Commerce Act that the terms and conditions prescribed by the Commission be 'just and reasonable' and those of section 5(2)(d) that inclusion be on 'equitable' terms. This contention is without substance. One of the conditions underlying our approval of the Penn-Central merger is the inclusion of the NH, and it contemplates the possibility of an immediate Penn-Central takeover of the NH operation with all its burdens."

based on 1968 figures (334 I.C.C. at p. 73, App. 160a).* Notwithstanding the increase of the loss, the Commission left the limit as originally fixed by it, although it no longer covered the indicated annual New Haven loss, with a view to not increasing the loss payment to be made by Penn Central over that originally fixed by the Commission.

The inclusion of the New Haven was delayed beyond the time of the Penn Central merger for the convenience and benefit of Penn Central as the Reorganization Court noted (289 F. Supp. at p. 461, App. 248a). Accordingly, the July 1968 Opinion of the dissenting Judge stated (289 F. Supp. at p. 449, App. 378a):

> "Had that which should have been done, been done at the time of the merger, New Haven then would have become a unit of Penn Central, with the latter necessarily absorbing operating losses from the date of the merger; to require Penn Central to do so now imposes no unjust or onerous terms upon it. Penn Central, as the beneficiary of the merger, would be assuming a burden which was part of a single transaction—this, entirely apart from the creditors' claim that, constitutionally, they cannot be forced to bear the increased losses entailed by the continued operation of the New Haven pending inclusion."

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* The first opinion of the three-Judge Court (289 F. Supp. at p. 444, App. 367a) invited the Commission to reconsider the limit in the light of current information, saying:

> "The original loss sharing formula, limiting Penn Central's burden in any year to a maximum of $5.5 million, was clearly predicated upon the agency's view that NH's fortunes had reached their nadir in 1967 and that the outlook for 1968 and beyond was somewhat less dismal 718-19. The Commission is free to consider, in the light of more current information, whether this assumption is correct."

However, the Commission in its Fourth Supplemental Report (334 I.C.C. at p. 74, App. 161a) made no change in the maximum.

Referring to such view of the dissenting Judge, the Reorganization Court said in its 1968 Opinion (289 F. Supp. at p. 461, App. 248a) that 'the cogency of what Judge Weinfeld said is apparent."

In the dissenting Judge's June 18, 1969 Opinion (App. 442a), he reiterated this view, saying, "Consistent with my view previously expressed, the entire interim operating losses should be borne by Penn Central."

The majority July 1968 Opinion (289 F. Supp. at p. 443, App. 365a) did not find the choice between the contending views to be "easy", but it accepted the Commission's arbitrary limitation on Penn Central's loss sharing.

If the $8,200,000 formula loss figure had been prorated for eleven months, Penn Central would have paid $7,500,000 of New Haven losses for the period instead of only $5,000,000 (prorated from the $5,500,000 maximum).

B. *The loss formula should not have excluded substantial items of New Haven losses.*

There was no basis for the arbitrary inclusion in the formula of some losses of the New Haven and the exclusion of others. Among those arbitrarily and wrongfully excluded are rent for leased roads—$734,000, and interest paid during bankruptcy (none of it on defaulted securities) —$1,936,000 (based on figures for 1968 taken from the New Haven's annual Form A Report to the Commission (p. 301A)).

The only explanation sought to be given by the Commission for exclusion (contrary to the proposal put forward by the New Haven Trustees) from the loss formula of the expense of rent for leased roads and interest paid during bankruptcy was (331 I.C.C. at p. 718, App. 76a) that they

"are more nearly capital charges, that is, costs of providing the railroad plant." But that we submit is no proper basis of exclusion. The key question is whether the New Haven had to pay from its depleted treasury amounts of 1968 expense charges which it would not have had to bear if the inclusion of the New Haven had been simultaneous with the Penn Central merger. Plainly, these two items totalling $2,600,000 for the year 1968 would have been paid by Penn Central for any period after New Haven's inclusion and such inclusion would have been effected on February 1, 1968 except for the postponement for Penn Central's convenience. Therefore, the New Haven's treasury should be reimbursed for 11/12s of such $2,600,000 which amounts to $2,380,000.

Either there was no equitable obligation on the part of Penn Central to pay any of the New Haven loss during the period from the date of the Penn Central merger to the date of its acquisition of the New Haven assets or there was an obligation to pay the entire loss. Obviously, as was stated by the dissenting Judge of the three-Judge Court (App. 378a, 442a), there was an equitable obligation on Penn Central to pay the entire loss. That there was such an obligation is clearly indicated by the fact that the Commission and *all* the Judges in the case, without exception, ruled that Penn Central should pay some losses of the New Haven during this period without any valid reason being advanced as to why it should be less than all.

We respectfully ask the Court to determine (contrary to the decrees of both Courts below but in accordance with the opinion of the dissenting Judge) that it was arbitrary and improper for the Commission (a) to fix a limit of $5,000,000 on the reimbursement to be made by Penn Central to the

New Haven for losses incurred during the eleven-month delay of inclusion for Penn Central's benefit (the formula loss for the period being $7,500,000) and (b) to exclude from the formula loss computation $2,380,000 of losses, *i.e.*, rent for leased roads and interest paid during bankruptcy.

POINT V

The ruling of the majority of the three-Judge Court as to the valuation of Oak Point and Harlem River Yards was erroneous and that of the Reorganization Court was correct.

(Question 12)*

In its July 1968 decision, the three-Judge Court ruled (289 F. Supp. at pp. 433-4, App. 344a-345a) that no adequate explanation was made in the Second Supplemental Report as to why the Commission had rejected the realty expert McCann's higher appraisal ($22,650,000) and accepted instead his lower appraisal ($18,100,000) of the value of the Oak Point and Harlem River Yards.

After the remand, Mr. McCann testified in the fall of 1968 (at the 1967 hearings, Mr. McCann had not testified but his two appraisals were put in evidence by the head of the New Haven's real estate department). It then developed that his lower ($18,100,000) appraisal assumed that upon the New Haven's liquidation the industrial users of these Yards would be left without railroad service while the adjusted higher appraisal ($22,540,000) assumed continuance of railroad service. It further developed that, when

* We understand that the First and Refunding Mortgage Trustee and Committee (the First Mortgage interests) will include in their briefs a comprehensive discussion of the valuation of the Bronx Yards (our Point V) and of the present worth discount (our Point VI) and we have therefore abbreviated our discussion of those items.

Mr. McCann made his lower appraisal, Mr. McCann did not know that between the Oak Point Yard and the New York Central's adjacent Port Morris Yard there was an existing railroad connection (Tr. p. 28881) through which railroad service to the Yards could be continued notwithstanding a liquidation of the New Haven.

In its June 1969 decision (App. 423a), the majority of the three-Judge Court nevertheless accepted the Commission's conclusion that, upon the New Haven's liquidation, there would be no railroad service to these Yards. On the other hand, the dissenting Judge of the three-Judge Court and the Reorganization Court were emphatic in ruling (Reorganization Court May 28, 1969 Opinion, 304 F.Supp. at pp. 807-8, App. 295a-297a; minority June 18, 1969 Opinion, App. 442a-443a) that the clarifying testimony introduced pursuant to the remand decision showed that the Commission's original $18,100,000 valuation had been made on an erroneous basis.

We respectfully ask the Court to determine that the Commission's adherence in the Fourth Supplemental Report to the original $18,100,000 valuation was without substantial support in the evidence and therefore unlawfully deprived the New Haven of $4,400,000 of value.

POINT VI

The Commission deducted an excessive discount to present worth from the proceeds of the assumed liquidation of the New Haven.

(Question 13)

The Commission in its Second Supplemental Report deducted $17,563,000 as a discount to present worth of the liquidation proceeds to be received over a six-year period of liquidation. Bondholder interests have contended that the record demonstrates that the discount of gross receipts adopted by the Commission was excessive by over $2,000,000.

The Reorganization Court upheld such contention of the bondholders and in its July 28, 1969 order (304 F. Supp. at pp. 1137-8, App. 318a) directed that the "sum of $2,415,899 should be added to liquidation value inasmuch as it was improperly deducted in applying the discount to present value found by the Commission . . . ".

In the Memorandum of the majority of the three-Judge Court dated September 11, 1969 (accompanying its Decree of the same date), the majority (App. 445a) refused to pass on the merits of this deduction on the ground that the precise amount of the deduction was calculated in a letter from bondholder interests dated June 17, 1969, received by both Courts after they had rendered their respective decisions in May and June. However, the decrees were then still to be formulated and such calculation was but one of several which had been made and submitted by bondholder interests subsequent to the Second Supplemental Report. Bondholder interests had contended in these proceedings, long before these Court decisions, that the discount of gross receipts to present worth was substantially excessive.

We submit that it was error for the majority of the three-Judge Court to refuse to pass on the merits of this issue.* The majority September 11, 1969 Memorandum said on this subject (App. 445a):

> "We have not passed on the merits of this contention since we do not consider it to be appropriately before us on settlement of the decree. The difference in the treatment of this item by the two courts will be another matter for ultimate resolution by the Supreme Court."

We respectfully ask the Court to determine that it was erroneous for the three-Judge Court to refuse to pass on the merits of the reduction of the discount to present worth (and the corresponding increase of the price payable by Penn Central) as approved by the Reorganization Court and that the Reorganization Court ruling should be sustained.

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* Incidentally, the September 11, 1969 Memorandum of the majority of the three-Judge Court refers (App. 445a) to the bondholders' proposed reduction of $2,695,899 in the discount to present worth while the amount deducted by the Reorganization Court in its order is $2,415,899 (304 F. Supp. at pp. 1137-8, App, 318a). The difference of $280,000 arises because of the issue as to whether the lower or higher appraisal of the Oak Point and Harlem River Yards is to be accepted. The Reorganization Court's lower reduction assumed acceptance of its higher valuation of those Yards, whereas the higher reduction mentioned by the three-Judge Court assumed acceptance of the lower valuation of the Yards.

POINT VII

Increased consideration should be in the "mix" (principally Penn Central stock) specified by the three-Judge Court; and the formula devised by the Reorganization Court and adopted in substance by the majority of the three-Judge Court and the Commission to guarantee the value per share assigned (or to be assigned) to the Penn Central stock received by the New Haven should be modified and, as so modified, should be approved.

(Question 14)

A. ***Any increase in the consideration should be in the same "mix" as the consideration approved in the Fourth Supplemental Report.***

During the negotiations with Penn Central* in 1964 regarding the terms of the purchase of the New Haven by Penn Central, it was insisted by the New Haven Trustees, and agreed to by Penn Central, that the bulk of the consideration should be in the form of Penn Central common stock. On this matter, Mr. Kirk, one of the Trustees, testified (Ex. NHI-65, p. 16):**

> "Thus, one of the principles for which we negotiated at considerable length was that the bulk of the consideration should be in the form of common stock or, failing that, should be debt instruments having either conversion rights or options which would permit the

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* In respect of events prior to the Penn Central merger on February 1, 1968, the references herein to "Penn Central" are to Penn and Central as separate organizations but working together.

** Exhibit included in Document No. 120 of the three-Judge Court record.

claimants to the New Haven's Estate to participate in the benefits of the merger". [Exhibit offered and received in evidence—Tr. 24363-4.]

Accordingly, the purchase price provided for in the tentative purchase agreement consisted mainly of 950,000 shares of Penn Central stock (taken at $87.50 per share—a total of $83,125,000), $23,000,000 of Penn Central 5% Bonds and $8,000,000 in cash.

The Commission had the following to say as to the purpose of the New Haven plan of reorganization which it approved in the Fourth Supplemental Report (334 I.C.C. at p. 94, App. 181a):

> "The trustees [New Haven trustees] conclude that in fairness to all creditors, the securities should not be sold but that a plan should be formulated to permit the reorganized company to receive and hold those securities intact awaiting achievement of expected benefits from the Penn Central merger, particularly the anticipated further increase in value of the Penn Central stock. Accordingly, the capital structure of the reorganized company and the allotment of equities to claimants and creditors of the NH estate have been designed by the trustees to accomplish this purpose."

There has been no dispute in the proceeding as to the desirability of having the bulk of the consideration in the form of an appropriate number of shares of Penn Central stock. And the three-Judge Court in its June 18, 1969 decision sustained our contention that any additional consideration should have approximately the same "mix" as the original consideration, saying (App. 431a):

> "The Commission is directed promptly to prepare and serve a proposed decree which, among other things,

shall reflect in dollar amounts the changes directed in this opinion. Increases or decreases in the price shall be in approximately the same ratio as the figures for PC stock, PC bonds and cash in the Remand Report, 334 I.C.C. at 71, bear to each other."

Thereupon, the Commission in its Fifth Supplemental Report (334 I.C.C. at p. 531, App. 225a) found that the small $990,000 of additional consideration developed by its calculation (pursuant to the three-Judge Court decision) should be "in the following 'mix' ", namely:

Stock	57.1%
Bonds	37.4%
Cash	5.5%

Those percentages were thereafter embodied in the decree of the majority of the three-Judge Court (App. 448a-449a).

As indicated above, the objections made by the First and Refunding Mortgage Trustee and Committee have not been directed against common stock forming the bulk of the consideration. They have objected to having to take such common stock at $87.50 per share while the market value on the Stock Exchange of the stock was considerably less.

We understand that the First and Refunding Mortgage Trustee and Committee adhere to the position that the difference between the Stock Exchange market value per share (as of an appropriate date) of the 950,000 shares presently included in the consideration and $87.50 per share should be made up by an increase in the number of such shares.

If the consideration heretofore approved is changed so as to include such stock therein at a price less than $87.50 per share and if the total amount of consideration is also increased in accordance with contentions made by the First

Mortgage bondholders and ourselves, the stock included in such increase in the consideration would naturally be taken at the same lower figure.

We submit that, as held by the three-Judge Court, any increase in the consideration should be in the same "mix" as the consideration approved in the Fourth Supplemental Report.

B. *The formula guaranteeing the value per share of Penn Central stock should be modified and, as so modified, should be approved.*

The Commission assigned a value of $87.50 per share to the Penn Central stock but the stock has not as yet sold at that price. Therefore, the Reorganization Court devised a formula (adopted in substance by the majority of the three-Judge Court and the Commission) which was intended to guarantee the realization of at least that price over the ten-year period following the Penn Central merger (304 F. Supp. at pp. 809-10, App. 300a-301a, 318a-319a, 429a-430a, 226a; 334 I.C.C. at p. 532).

The basic provision of that formula is that Penn Central would pay the New Haven on February 1, 1978 the excess, if any, of $87.50 per share over the mean price of the Penn Central stock for the 30 business days next preceding that date. However, because of the two "outs" in the formula which are referred to below, the formula does not carry out its purpose.

The two "outs" mentioned above are:

One. Penn Central has no obligation to make any payment if the market value of the shares reaches and maintains $87.50 on the New York Stock Exchange for only five consecutive days at any time before February 1, 1978; and

Two. Penn Central is also relieved from any further obligation in respect of specified blocks of the shares by designating, five days in advance, any business day prior to February 1, 1978 and paying to the New Haven the deficiency, if any, between the quoted sale price of the shares on that day and $87.50 per share.

We submit that the operation of either of these two "outs" would invite the reorganized New Haven to sell Penn Central shares in advance of the termination of the formula period. Whichever one of the "outs" was involved, its operation would put pressure on the directors to sell Penn Central shares at an early date in order to avoid criticism if the price of the stock should subsequently decline.

More specifically, if the Penn Central obligation expired because the $87.50 price was maintained for five days well before the end of the ten-year period, the directors would in all probability sell shares promptly in that market because they no longer had the protection of the Penn Central obligation. Similarly, if Penn Central were to terminate its obligation in respect of large blocks of shares by paying a deficiency based on transactions of a single day, the directors could be expected to sell those shares at a price which, including the deficiency payment, would realize $87.50 or near that figure in order to protect themselves against a possible subsequent decline in the market price.

On the other hand, if New Haven directors have the unconditional assurance of eventually obtaining at least $87.50 per share at the end of the ten-year period, they would have the incentive to hold the stock intact, as is the intention of the reorganization plan, in order that the New Haven have the opportunity to realize substantially more than $87.50 per share.

In the discussion above in this subdivision (B), we have addressed ourselves to the terms of the present formula which guarantees the price of $87.50 per share. As contended by the First Mortgage interests, such assigned price for each share of stock included in the present and in any increased consideration may be reduced under the forthcoming decision of this Court to an amount below $87.50 per share. In such event, the guarantee formula can easily be made applicable to such reduced price by substituting the amount of such reduced price for $87.50. The arguments set forth above in this subdivision (B) would then be completely applicable to the guarantee formula as so revised.

We respectfully ask the Court (a) to require that the guarantee formula be modified so as to remove the two conditions which might prematurely terminate Penn Central's formula obligation and (b) to approve (or not to disturb) the ruling of the three-Judge Court (App. 431a) that any increase or decrease in the price be in the same ratio of Penn Central stock and bonds and cash as the consideration approved by the Commission in [illegible] I.C.C. at p. 71 (App. 158a).

CONCLUSION

We respectfully ask that the Court:

(a) Dispose of the Questions Presented hereinbefore set forth by answering in the affirmative all such Questions except Questions 2 and 5 and by answering Questions 2 and 5 in the negative.

(b) Require the three-Judge Court to modify its judgment as heretofore entered by that Court

(i) by approving the Commission's finding that the net liquidation value of the New Haven assets sold to Penn Central (and the basic price payable by Penn Central) is $162,700,000 (such finding being increased by $990,000 as provided in said judgment and further increased as set forth below);

(ii) by disapproving the Commission's deductions from such net liquidation value of $15,386,000 as a "delay" discount and $6,695,000 as a "bulk sale" discount;

(iii) by directing the Commission to add to the aforesaid net liquidation value (and correspondingly to the price payable by Penn Central) (I) a substantial value for $5,600,000 of annual net income (being the New Haven's partnership interest in such net income derived from the Grand Central hotels and office buildings heretofore used to defray the New Haven's user share of Terminal expenses) transferred to Penn Central without consideration, (II) $4,400,000 additional value of the Harlem River and Oak Point Yards and (III) $2,400,000 to correct the excessive discount to present worth;

(iv) by directing the Commission to require Penn Central to reimburse the New Haven for unreimbursed losses incurred by the New Haven by reason of the fact that New Haven's inclusion was delayed for eleven months for the benefit of Penn Central; and

(v) by modifying the guarantee formula in respect of the Penn Central stock by eliminating the two conditions which might prematurely relieve Penn Central of further obligation under the formula.

(c) Require the Reorganization Court to modify its Step I judgment as heretofore entered by that Court

(i) by directing the Commission to add to net liquidation value as reflected in that judgment (and correspondingly to the price payable by Penn Central) a substantial value for $5,600,000 of annual net income (being the New Haven's partnership interest in such net income derived from the Grand Central hotels and office buildings heretofore used to defray the New Haven's user share of Terminal expenses) transferred to Penn Central without consideration;

(ii) by modifying the guarantee formula in respect of the Penn Central stock by eliminating the two conditions which might prematurely relieve Penn Central of further obligation under the formula; and

(iii) by ordering the Commission to require Penn Central to reimburse the New Haven for unreimbursed losses incurred by the New Haven by reason of the fact that New Haven's inclusion was delayed for eleven months for the benefit of Penn Central.

(d) Approve the ruling of the three-Judge Court that any increase or decrease in the consideration be in the same ratio of Penn Central stock and bonds and cash as the

consideration approved by the Commission in the Fourth Supplemental Report.

Respectfully submitted,

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